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SME Environment Assessment

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TABLE OF CONTENTS

I. INTRODUCTION, ISSUES AND PRIORITIES

1. Introduction

The growth of a healthy, competitive SME sector will be maximized when there is a strong enterprise culture in the society at all levels; a continuous growth in the quality stock of independent business; maximum potential for growth of existing small businesses: and a highly supportive economic, social and stakeholder environment. OECD, 2004

The level of small business development depends significantly on society's attitude to small business and entrepreneurship. Bizpro, 2002

Small and medium enterprises (SMEs) are foundational to developed economies. In Georgia, the state formerly took responsibility for job and wealth creation through large industrial combines and agricultural cooperatives. However, with the change to a market-based economy, Georgia must now encourage SME growth more actively, in order to stimulate economic development.

An essential part of developing a thriving SME environment is a legal framework that includes fully operating institutions to enforce laws. This allows for commercial growth by reducing unfair competition, providing stability and increasing trade opportunities. The legal system also ensures that SMEs have improved access to the capital they need for investment and success. Good infrastructure will facilitate market realization. SMEs will also need business development services to enable them to understand and face the challenges before them.

USAID commissioned this assessment of the SME environment in Georgia to support the design of a possible program for SME development to be funded by the Agency. This assessment is built on both expert analysis of extensive existing material on SMEs in Georgia and interviews with private sector, government and donor representatives. GEGI held a roundtable in Tbilisi on November 18, 2004 at which 39 participants discussed SME needs and expectations (see Appendix B). Roundtable participants provided input on barriers and validated preliminary conclusions and recommendations. One-on-one interviews were subsequently held by the GEGI team to further strengthen the findings and proposals herein (see Appendix C). Some project materials are attached to provide more detail (see Appendix F).

2. SMEs in Georgia

A small enterprise is defined by Georgian law as having a turnover below GEL 500,000 and up to 20 employees. In 2002, the Department of Statistics recorded 23,094 such legal enterprises, excluding single entrepreneurs. Of these, 66% were individual owned, 28% limited liability and 3% state owned; 85% employed one to five, a further 10% six to 15, making up 24% of the workforce. Most SMEs are in trade and repair (68%), followed by processing (11%), hotels and restaurants (5%), real estate (5%) and transport and telecom (3%). By August 2004, the Department listed 3,518 active companies; estimates of the shadow SME economy range 26-35%.

There are three forms of SMEs in Georgia – wholly illegal, mixed, and wholly legal. Most SMEs are mixed, having some legal operations and some in the shadows; few if any are wholly legal. The environment is not conducive to legalization. The Georgian economy is generally made up of very large concerns and micro, marginal enterprises, there is no real medium size enterprise segment. All smaller businesses have political connections ("крыша"), while semi-large outfits are formerly state owned. The structure of business must change, it must move away from the state. Elsewhere, small enterprises fail or grow to medium size, in Georgia micro-enterprises may get to small but fail to grow further.

It is also important to determine what kind of SMEs Georgia harbors. What activities are covered? What else could SMEs do in Georgia? The needs of SMEs are not uniform, either. Rural SME development will need to consider three different sectors, with different needs: farm production, processing, and agribusiness services.

Donors claim to have assisted vast numbers of SMEs, but most of these appear to operate informally. It may be wiser to concentrate assistance on fewer, larger ventures, which might achieve certain economies of scale, be more sophisticated in their scope, and transparently employ more people at higher wages: not everyone is an entrepreneur, especially in a country which culturally fosters a negative attitude towards amassing wealth. A recent survey also argued: "the heavy focus of public debate on the problems that hamper the development of the Georgian economy and business may be accountable for the widespread belief among Georgian businessmen that they are generally better off (e.g. in performance, or in being less disturbed by administrative bodies) than an average Georgian businessman is. Such beliefs, not only among businessmen but in all segments of social life, may have important negative implications in terms of reluctance to strive for a better environment." Another gave points to the new administration for increasing SME potential by reducing the cost of the traffic police on rural transport, lowering lending rates through increased competition, work on property registration, increasing pensions, education reform, increased revenues available for infrastructure rehabilitation.

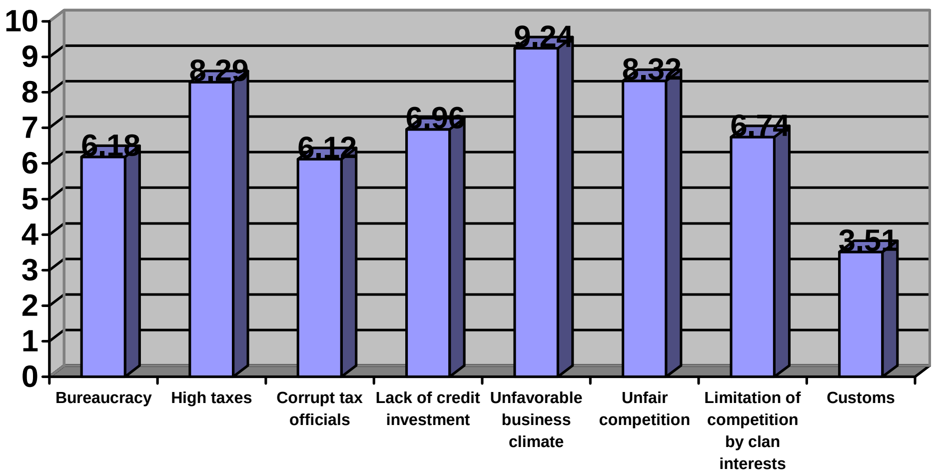
3. Cross-Cutting Issues

In Georgia as elsewhere, there are a number of problems with the overall operating environment which affect all economic agents, including SMEs. Five key cross-cutting issues can be highlighted, as follows.

The general political and legal environment, over a year from the Rose Revolution, has yet to settle. Government officials are frequently moved, thus being given little opportunity to evolve or implement policy, nor indeed develop working relationship either inside Government or with the private sector and broader community. It could be argued that in fact, few individuals within Government are trusted to prepare and manage policies and laws, and that permanent reshuffling is being used to ensure this continues. Whatever the motivation, this results in an unstable political and legal environment guaranteed to unsettle business and investment in general, and smaller operators in particular.

A related cross-cutting problem, cross-cutting both as to whom it affects and its breadth of impact, arises with legislation and its enforcement. The entire system is flawed, from initial drafting of laws before policies are decided and without consultation, to actually getting a ruling enforced. Enormous concerns are raised across the board over issues to do with the level of education and training of judges and court officials, interpretation of the Law, independence of the judiciary, corruption of justice, low capacity, and the inability to enforce fair, binding and timely rulings. In such a setting, the population and especially entrepreneurs distrust the courts and prefer to operate in an informal fashion, avoiding government scrutiny against which they have little recourse but perpetuating bad contracts and poor protection of buyers, sellers, labor and consumers. There are few incentives for going legal.

Factors Inhibiting Business Development (from 1-least negative to 10-most negative)



Oxfam, 2004

Certain basic rights, in particular that of ownership, are still not secure. This of course affects many aspects of developing a business, starting with the initial decision to open if property is not guaranteed and continuing onto access to finance. In this respect, the Law on Investment is deemed unclear, thus undermining investment. In such circumstances, there is great temptation to “stay below the radar” and operate in an informal, illegal setting.

Infrastructure is also a common problem and represents a significant burden to the supply chain. The highly centralized network inherited from Soviet times does not fit today’s needs, and at any rate is in dire disrepair. While Georgia is rather urbanized, those in the rural areas are truly isolated. With poor roads, limited irrigation and often no power, these areas are disenfranchised and unlikely to develop. Infrastructure problems are linked to territorial issues in Georgia, both in that certain groups claim possession over some resources, and in that the overall system will not be improved until some of the territorial disputes are settled. Conversely, worldwide experience has shown that a well-developed SME sector reduces the risks of social conflict, in part by creating a middle class interested in stability.

Perhaps the single most important cross-cutting issue for Georgia rests in one interviewee’s question:

is there a coherent policy for Government getting out of the way of business?

At present, there is no clear understanding – in either Government or the broader population – of the role of Government in business, and in developing business. The old attitudes continue: business is bad, the state must control, only the state can provide, entrepreneurship is another word for theft… As a result, all aspects of doing business are subject to “intense regulatory attention”, increasing costs to business but also to Government *and* poor consumers, erecting unnecessary barriers to normal *and* legal operations, and perpetuating a system which provides low protection and fosters corruption and cheating. Georgia’s current policies do not facilitate Government divesting itself from economic life, whether by positive choice, nor indeed because of in-built, systemic conditioning.

4. Priorities

The following are key priority areas to be addressed when looking to develop SMEs in Georgia.

Cost of Compliance – SME are subject to "intense regulatory attention", being plagued by visits from various controlling agencies, all of which enjoy better information and limitless power, and abuse these to extort illegal payments from weaker economic agents. A recent survey suggested this cost may have fallen in the last year, but this might be attributed to general government restructuring which might have temporarily disrupted informal collections. The same survey found no causal relationship between administrative barriers and SME growth, though it noted that SMEs had grown slower than the economy as a whole over the same period.

Legalization – One possible explanation for the slower recorded growth of SMEs is their non-legalization, or rather the legalization of larger units unmatched by SMEs. In today's setting, operating legally offers little advantages for much administrative disruption. Laws, rules and regulations are unclear and not transparent, officials abuse their powers, the courts offer no remedy. SMEs tend to live hand-to-mouth and therefore prefer to keep a low profile and stay in the shadow.

Unfair Competition – Because of the high cost of compliance and ensuing tendency to operate informally, those SMEs that try to operate legally if only partly, suffer from unfair competition: where a competitor is able, by bribery or fraud, to avoid the costs of complying with the laws and official rules and thus can undercut those who comply. In Georgia, where most businesses including large ones do not operate 100% legally, this type of competition is rife. Because unfair trading practices are also poorly defined and policed in Georgia, collusion, price fixing and other abuses of market power are common.

Access to Finance – SMEs are typically owner-managed and started with funds from friends and relatives. This constrains growth. Many donor programs have looked at bridging various gaps to increase SMEs' access to finance. This includes on-lending facilities, microfinancing, credit unions etc. The basic hurdle however stems from the quasi-impossibility for recovery under current laws and institutions. Securing a loan is very difficult because property rights are ill defined and unregistered. As a result, lenders oversecure loans and impose onerous bureaucracy and costs, particularly on unknown, unestablished startups and SMEs.

Human Resources Development – Georgia enjoys a relatively well-educated population, but the system fails to supply the skills necessary in a modern, market-driven economy. SMEs also rely on friends and family for their staffing needs, which can further constrain growth. Owner-managers find it difficult to relinquish control over their enterprise even when better qualified management is available to them. Donors are also working on providing various business skills, but lack coordination in their programs.

Information – SMEs have poor access to information, either because they do not know where to find it or because there are vested interests against their accessing information. Often, SMEs are limited in their vision, being cantoned by a single buyer or seller, or looking merely at their local market and one product or service. "Intuitive" linkages are not made because entrepreneurs are unaware of each other or of facilities open to them. Authorities are prone to obscure information in a bid to abuse their power.

Government Communications – There is no avenue for SMEs to voice their concerns or promote their interest. Government is generally deaf to business, except where personal connections exist. Obsolete attitudes that view the state as the ultimate controller of all economic activity encourage Government to devise policy and laws in isolation, rarely consulting the (better informed) community therefore failing to build understanding or support. The system is also rigid, in that it makes little provision for decisions to be revisited once their impracticality has been demonstrated. SMEs tend not to formalize or associate, given them even less of a voice and no access to Government.

Rural Specifics – All the above worsen as distance from the center increases. In the regions, problems are also recorded with rural space security, rural infrastructure, and rural production information. There is great need to clarify the mandate of local government and its rules, and to make it more transparent in particular as regards local taxes, allocation of market space, and pricing. The establishment of semi-formal dispute resolution will be instrumental to building trust in order to facilitate the creation of cooperations and associations to increase bargaining power. Agriculture and agribusiness that is small scale, with small operations based on small power sources and small equipment offers potential for SME development in input supply, consolidated centers (with collection), production services, transportation, wholesaling and marketing.

Georgia needs a coherent approach that will feed into a clear strategy and specific program. This will start with defining SMEs in Georgia and analyzing their needs, then policy setting and management, with stakeholder development, institutions building[1], and the elaboration of a strategic plan based on values, experience, objectives, targets, obstacles and monitoring. The European Charter for Small Enterprises is reproduced at Appendix E. In general, central Government should delegate its power to the local level, where the stakeholders are better able to appreciate problems and devise practical solutions. The state should take a long term view and avoid imposing detailed programs or targets. It should also be weary in providing services or becoming an overwhelming customer. Government can best aim to remove obstacles to entry, operation and exit from the market, and stand aside.

[1] The State Ministry for SME Development was created in August 2004 and abolished in December.

II. LEGAL AND REGULATORY ENVIRONMENT

The laws regulating business in post Soviet countries are based on the inherited system of control of all aspects and activities, which breeds unnecessary and cumbersome bureaucracy, and erects artificial roadblocks to business development in general. SMEs, by their specific nature and needs which are often ill understood (especially coming from a Soviet framework), can be particularly susceptible to these conditions, leading to underdevelopment of the sector, or its development into a shadow, unregulated economy.

To flourish, business (and SMEs) principally requires a stable environment. This is grounded in a proper legal and regulatory environment. However, from a business standpoint, entrepreneurs analyze the environment in terms of their ability to engage in profitable economic activity, not in terms of laws. To achieve prosperity, SMEs must capture sufficient revenues to cover costs, manage risks, and obtain a reasonable return on their investments. If these factors are out of balance, entrepreneurial activity is stifled, and many businesses opt for the informal sector where lower costs compensate the inherent risks.

To support SMEs, the environment must minimize non-market risks through clear definition of commercial rights, enforcement of those rights, and stable systems for managing changes in laws and regulations. The environment must also ensure that non-market costs of doing business in the formal sector – such as costs imposed by bureaucratic impediments – are low enough to be borne by SMEs without destroying profitability. Finally, the business environment must maximize the potential of SMEs to compete for sales revenues by regulating anti-competitive behavior and enlarging markets.

Imbalances can occur at several levels. While lack of or bad laws and regulations cause the most obvious imbalance, a good process can mitigate risks and improve consensus on implementation. Implementation normally flows from consensus in the lawmaking process; enforcement depends on the quality of enforcement institutions: if the process lacks a mechanism for building consensus, stakeholders must rely more heavily on enforcement institutions, normally at higher cost and risk.

There is a lack of capacity in the Government of Georgia for developing policies and implementing laws, regulations and policies both to shape the overall business environment and at the level where SMEs operate. Compounding this lack of public capacity, there are no meaningful, formal (nor indeed mandatory) consultation mechanisms for input by private business and SMEs, nor a standardized system of impact assessments. Georgia has no integrated, coherent approach to business, economic growth or trade, and no government-business partnership. While this continues, SME development and thereby economic growth is constrained. Overarching problems with the judicial system, including its lack of independence, corruption, low levels of training, slow processing speed, poor enforcement, and absence of a credible alternative, exacerbate Government's isolation and fail to move the system forward by making it accountable and responsive.

The analyses below cover current efforts and gaps in more detail for several key areas: business registration; certifications, approvals and inspections; bankruptcy; secured transaction environment; tax and trade, competition and labor. These impact both start-up costs and daily operation of SMEs, and thus affect development potential.

1. Company Registration

By registering a business, owners enjoy the protections normally inherent in operating within the legal system. This includes access to courts, licensing and permits, protection from unfair competition, and various other benefits offered to formal actors. The fees and complexities of registration are sunk costs recovered only through long-term profitable activity. If the process is too complex, business owners lose time better spent in generating income. If the costs are too high, entrepreneurs either forego new business or pursue it through the informal economy. If registration increases risks – by making a company the target of unwarranted inspections, for example – many businesses will also opt for the informal economy.

From a government perspective, registration is vital for taxation and regulation of business activity. A well-functioning system also permits statistical analysis for setting policies, determining revenue collections, and monitoring economic trends. While SMEs do not necessarily care about these governmental issues directly, they do care about improvement of government services affected by registration (such as policymaking or prosecution of informal activity). Simple, inexpensive (money and time) and risk-free registration encourages SMEs, which typically start up with limited resources, to operate in the formal, measurable and regulated economy.

In Georgia, registration is governed by the Law on Entrepreneurs (1994) which lays down the legal basis for company registration. As a result, company registration is relatively simple and straight-forward and is not reported to be an impediment to investment and business. The procedures are well-known and there is the option to have legal offices undertake the process for fairly standardized fees, though documentary evidence is often reported as burdensome, including disclosure of private information that may not be relevant to the purposes of registration. There is also evidence that self-registration takes longer (14 days instead of 9½ by third party) but costs less, with some suggesting intermediaries have too much interest in the registration process.

The key problem with company registration in Georgia however, is that it takes place in up to 73 local courts, and there is no real centralization or collation of the data. As a result, it is at best time-consuming and costly to establish records, from whether a name is already in use, to who owns a company, to there being claims over a business. One of the critical elements to improving credit access and the successful operation of secured transactions is the use of exact names of debtors, which are often business entities. The existing company registration process is not conducive to ready and reliable access to information on business entities, with registration dispersed across the country. None of the registries are automated, and registries generally do not respond to inquiries over the telephone. Access to exact information is either through the court to submit a request, or to have an agent in the locale of the court do so, assuming the registration locality can be determined with some certainty.

Another problem with the existing process is that a name may be used by multiple entities in Georgia because registration is local, and names are not checked centrally. It is therefore possible that a search by debtor name turn up a list of security interests that includes those filed against other debtors of the same name, making it very difficult to determine the situation of the debtor of interest. The need for reliable and ready data about business entities is not limited to secured transactions, it is often the basis for informed business decision-making.

The idea of a simplified registration process for SMEs is an appealing one. The use of a single registration form which would serve the Ministry of Justice, tax authorities and the Department of Statistics however, is not desirable at this stage. This is because governmental agencies do not have the maturity necessary either to distribute the information or respect its confidentiality. Until the institutions are stronger, it remains preferable, though more onerous, to have separate registration documents. In contrast, simplified procedures, which might include the possibility to retrieve and file all documents in the same place, should be explored.

Current SME Environment
▪ Different authorities register different business types ▪ Business must register with courts, with tax authorities, and with the Department of Statistics individually as they do not interface with one another ▪ In addition to actual registration fees, there are many attendant fees to pay, e.g. for notary services ▪ There is no centralization of records, thus no analysis or information value.
Recommendations
▪ Reform Completion: authorities have reportedly not yet fully adopted the new laws statewide, creating disparity and confusion ▪ Reform Expansion: more simplification is needed to bring SMEs within a formal framework, in particular in agriculture and for sole proprietors, traders, and partnerships, which comprise a significant segment of SMEs ▪ Information and Education: many past changes have not been widely advertised and thus are not implemented, a similar situation is to be expected with further reform unless training is provided, to cover both administrators and existing and potential users (broad dissemination campaign) ▪ Public Education: on the role and importance of SMEs in the economy; many officials, potential investors and in the broader community still hope for the resurrection of large enterprises to provide jobs, which will not happen; facilitating formal SME establishment may change attitudes and bring out entrepreneurship.

2. Licensing, Certifications, Approvals and Inspections

Government has a legitimate interest in bringing commercial activity into the formal sector: it must ensure a sufficient tax base and regulate certain activities, such as those affecting safety and public health. This requires approvals and inspections to ensure compliance with laws and regulations. However, from the SME perspective, every requirement imposes costs that affect profitability and potential for success. Georgia must build a business environment on rational costs that can be readily absorbed by the market; otherwise SMEs will go out of business or move operations into the informal sector. To promote SME growth, Government must find a way to simplify, rationalize and manage these necessary formal burdens to allow businesses to prosper and compete effectively. Government must enforce relevant regulations equitably, consistently and predictably to lower the risk of competitors evading the law to obtain unfair (and illegal) advantages.

Because of the redistribution of fees linked to licensing and permits, certifications and various approvals, and the potential for unofficial payments tied to inspections, controlling agencies have multiplied and these instruments have proliferated in Georgia beyond any measure of economic or regulatory sense. Far from protecting health and safety, the system has spawned endemic corruption, pervading inefficiency, and introduced risks which can be argued to outweigh any benefits from regulation as it stands today. It has been reported that licenses are in fact too easy to obtain, both harming consumers and creating unfair competition. Certainly the costs of the system, to business (especially SMEs who complain in particular of the heavy documentary burden), consumers and indeed the state itself, greatly exceed any actual protection value. In part because of the excessive and abusive use of these controlling tools, SMEs often choose to operate in the informal, unregulated economy. Because SMEs represent an important segment of the economy for much of the population, the lack of meaningful regulation and consequent absence of protection is widespread.

Inspections are sited as impediments for two key reasons: paperwork and disruption. Interestingly, SMEs do not report payments related to inspections as particularly harmful to business. A recent Oxfam survey found that just under half of SMEs made unofficial payments of GEL900 on average, with the majority of those payments being monthly. Yet SMEs complain of the amount of documents required at each inspection rather than official or unofficial payments, hinting at acceptance of corruption as a normal cost of business. The frequency of inspections, in part due to the number of controlling bodies, is a disruption to business operations. Tax authorities, sanitary and fire inspections, electricity supervision and Sakstandarti are the worst offenders. The average number of inspections is three, but can rise to 14.

The current system of standards, inherited from the Soviet command-and-control mindset, imposes mandatory local testing and certification of all products imported into, produced in, or exported out of Georgia. There are many problems with this approach, including increased costs with no added value since the testing and certifying capacities of Georgia are very limited, and rampant corruption. One of the many abuses of the system consists in restricting the choice of the certifying agency to be used, even when certification is voluntary, raising costs by an average of GEL58 per test (EPRC).

While regulation of economic activity continues at illegitimate levels, there will be great resistance to compliance from business. This perpetuates a need for costly enforcement by the state, rather than encouraging a partnership for compliance, where the costs are shared between Government and the private sector. If Government can rationalize regulatory instruments, in dialogue with business, to where regulation is recognized as protecting health and safety while not impeding profitable operations, businesses will actually support compliance and enforcement: it is in their interest to maintain a healthy and trusting customer base. **GEGI** is involved in some of the legal and institutional aspects of licensing and inspections, as well as in standardization, at the macro, policy level.

Current SME Environment

- **Licensing**
- The intent and scope of the Law on Licensing was narrowed by proliferation of additional and duplicate regulations
- Some sectoral licensing laws do not comply with the provisions of the framework Law on Licensing
- There is insufficient monitoring and oversight over licensors
- Licenses can only be obtained in Tbilisi from the central governing organization

- **Permits**
- There is no clarity in the purpose of permits, nor consistency on terms of permits from region to region
- The issuance of local permits is not regulated consistently statewide
- High levels of corruption in obtaining permits are reported, in particular for construction and trade

- **Inspections**
- 44 entities supervise and control business activities and tax payment, leading to many overlapping functions
- Inspectors often misinterpret laws and amendments, SMEs suffer from information asymmetry and have no legal recourse
- Long and expensive appeals process, with business bearing the burden of proof
- Rules regulating number, frequency, scope and procedures of inspections have led to some improvements, but are not strictly applied.

- **Certification**
- The standardization system falls far short of international best practice, including voluntary compliance, adding unnecessary costs to SMEs.
- Georgian certification is not recognized abroad, restricting export potential.

Recommendations

- All regulations should be subject to five principles: transparency, accountability, proportionality of the punishment to the crime, consistency, and targeting to avoid distortions
- Define the Parameters: accountability requires a clear definition of roles, responsibilities and obligations
- Eliminate Redundancies, Standardize Fees, Develop Written Mandates and Codes of Conduct
- Reform the Standardization System
- SME Bill of Rights: to correct information asymmetry and help SMEs understand their rights and obligations, a corollary to written mandates for controlling agencies
- Accountability: as a function of transparency, disseminate and distribute information on administrative mandates, duties and rights; as part of broader public education on civic rights and obligations
- Log Books: to support transparency and accountability and reduce corruption, introduce inspections registration log books detailing all inspections and inspectors, countersigned by inspected, and kept by SME
- Enforcement: provide both the authority and the means to monitor compliance meaningfully, and support effective appeals system.

3. Bankruptcy

Bankruptcy is a system for ensuring the equitable payment of debts when a debtor is no longer able to meet his commercial obligations, either by reorganizing or by liquidating the debtor. It also provides assistance to troubled debtors by providing relief from debt so that they can be reorganized for productive activity instead of simply being liquidated. For SMEs, bankruptcy provides certainty of assistance in collecting debts from debtors and a way to meet or relieve their own debt burdens should they become overextended. Moreover, an efficient bankruptcy system lowers the risks from non-payment, so that lenders are better able to provide access to capital at affordable rates.

In transition economies, bankruptcy serves an additional function: to clean up defunct and ailing state-owned enterprises (SOEs) for privatization or liquidation. SOEs are typically burdened by heavy non-commercial debt (loans made for political or other reasons without regard to commercial viability) and their liquidation comes with high political costs national leaders are reluctant to pay. The bankruptcy system thus becomes a means for settling political issues with economic consequences. Unfortunately, bankruptcy has often been a source of state-assisted fraud and theft in transition economies. This has contributed to a very negative attitude towards bankruptcy.

On June 25, 1996, Parliament adopted the Law of Georgia “On Bankruptcy Proceedings”. Between 2001 and 2004, this law was significantly amended. In practice, neither creditors nor debtors file bankruptcy petitions in Georgia with any frequency. This situation endures because the law on bankruptcy proceedings is not adequate in terms of either overcoming the financial difficulties of a debtor or satisfying the claims of creditors. There are several reasons for this. In particular, due to complicated procedural provisions, it is easy for debtors to employ delaying tactics; it may take as long as three months for bankruptcy proceedings to commence. Moreover, poor knowledge of the law and abuse of power by judges and bankruptcy administrators contribute to delays in the bankruptcy process, as well as resulting in incorrect legal decisions by the courts. An additional problem with current legislation is that the state enjoys preferential treatment over unsecured creditors, creating detrimental discrimination among creditors. Current rehabilitation procedures are not adequate either: limited access to credit during the rehabilitation process (where banks refrain from extending loans to insolvent enterprises) significantly weakens the ability of an individual or enterprise to recover.

GEGI grantee “Article 42 of the Constitution” conducted a survey in order to identify major issues for bankruptcy in Georgia (some of these identified above), while **GEGI** established a legislative working group on bankruptcy in May 2004. The working group, under the leadership of the Ministry of Justice and in coordination with the **EBRD**, is developing new legislation to address some of the problems with bankruptcy in Georgia today. The bankruptcy system will be enhanced through either amending existing legislation or developing a new law on insolvency. Once improved legislation is in place, judges and bankruptcy administrators will receive training on the new system and procedures. In parallel, a public outreach campaign will be conducted in order to inform the business and broader community of the new bankruptcy framework and promote its effective use.

Current SME Environment

- Law on Bankruptcy Proceedings enacted in 1996
- Few cases have been filed
- Judges and administrators abuse the system
- The state enjoys preferential creditor treatment
- The public views bankruptcy as resulting from failure, shameful or "getting away" with dishonesty

- Amendments are being drafted addressing all aspects of the ailing system
- Training will be provided by GEGI on the agreed new bankruptcy system
- A public outreach campaign by GEGI will support greater and better use of the improved system.

Recommendations

- Increase Capacity of Judges and Administrators: formal and on-the-job training to master both the legal system and the business economics and finance necessary to pass prompt and expedient judgment
- Public Education: targeted at government officials, community leaders, consumer organizations, business and others, to change basic popular misconceptions and understanding and address reasonable fears over possible misuse
- Separate Bankruptcy and Privatization: to address real and perceived problems with liquidation of SOEs
- Harmonize Bankruptcy and Corporate Governance: to prevent defrauding of creditors (including employees)
- Monitor Reform Needs: bar associations, banking associations or trustee associations monitor law and practice, and propose changes or develop educational materials to address observed needs.

4. Secured Transactions Environment

Secured financing substantially reduces the risks involved in advancing credit by providing valuable assets to reduce the risk of loss to creditors in the event of non-payment by debtors. Creditors value collateral based on their ability to liquidate it rapidly at market value. Assets that cannot be used as collateral have been described as "dead capital", costing SMEs worldwide billions of dollars in investment capacity. Collateralization of this capital requires adequate definition of property rights, a system for registering such rights, and efficient mechanisms for resolving disputes over those rights and for enforcing the rights. With these in place, secured financing increases the availability of credit and improves its terms for SMEs. Clear ownership rights also increase the level of investment in property, leading to more permanent, long-term investment.

An adequate legal infrastructure must include both movable and immovable property within the secured financing regime. Modern laws further provide that interest can be granted in any form of movable property with commercial value, whether tangible or intangible, permanent or transitory. They recognize a broad range of financing devices including pledge, fiduciary transfer, financial leases and chattel mortgages. For immovable property, modern laws permit secured interests in leaseholds, rights of use, easements and financial leases, as well as securitization with leases, mortgages and interests. Finally, an efficient system has integrated priority rules to regulate competing claimants to the same property, including the state, secured lenders, lessors, judgment creditors, bankruptcy trustees, employees and buyers of collateral (e.g., for inventory). Generally, this is achieved through registration of rights. A well-designed system significantly reduces the need for judicial involvement because it prevents many disputes from ever going to court and simplifies determination of priority and enforcement issues when the courts do get involved.

Current Georgian legislation related to Secured Transactions addresses only one type of security interest in movable property, the pledge. The law (Civil Code, Articles 254-285) does not address other common forms of security such as retention of title upon sale and financial leases, nor does it deal adequately with other transactions that look like security interests, such as long-term true leases, consignments, or sale or assignment of accounts. Observed deficiencies that act as obstacles to smooth business operation in Georgia in general, and to SME development in particular include:

- The law governing security interests in movables is limited to pledges, and does not address other forms of interests that may have priority in pledged collateral
- The creation of a security interest is bound by expensive and cumbersome formalities and requires public disclosure of sensitive information
- There is no reliable way of determining the priority of a security interest against other forms of interest in collateral
- A secured party must provide burdensome direct notice of its interest to all prior secured parties in the collateral and, if the collateral is an account, to all account debtors
- The registration office is not effective, and the law does not include a venue provision, so that information retrieval is onerous
- Enforcement in the event of default requires judicial process and takes so long that movables are likely to lose their value before realization.

Much of this is related to problems with the Pubic Register: the register is solely paper-based, while the Civil Code imposes heavy information disclosure for registration (such as notarized security agreement with the amount of the obligation, the interest rate and the payoff date, none of which contribute to the essential notice). The law also presumes truth of information that is not only unnecessary to the purpose of the registry, but impossible to substantiate. Moreover, registry office information is not very accurate, in that it fails to exactly capture the information that is provided. (The burden is on the filer to provide correct information: if the filer provides erroneous information, he risks losing his priority if the error makes the notice undiscoverable.) These technology system and procedures are not adaptable, without significant expense and time, to new processes that may be required by changes in the law.

GEGI identified these problems and established a legislative working group which prepared draft laws on both Secured Transactions and a Movable Property Registry. These drafts were share with the Ministry of Justice and exchange of comments and reconciliation (in particular with EBRD model) ensued. The two pieces of legislation are expected to be presented as a package to Parliament possibly in March 2005.

A related issue is that of SME access to land, both agricultural and non-agricultural. Land was privatized quickly at independence, based on social priorities to provide everyone some subsistence plot. Unfortunately, this has resulted in problems with legal claims, land fragmentation and inefficient parcel size (in the case of farmland). Because the land donation was free of all charges (including registration), there is great reluctance to rationalize allocation, at least formally, among smallholders. However, this reduces SMEs' access to land, either because it is not available for sale or because it is not economically efficient. **KfW** has done extensive work to establish a workable cadastre to support ownership rights and land consolidation. It is now working with **APLR** and the Public Register to renumber plots according to modern techniques to allow for easier transfer of rights. Independently, some experts propose the establishment of a State Property Financing Agency similar to the US Federal Land Bank, which would help finance the sale of remaining state-owned land using debt rather than scarce SME cash resources.

Current SME Environment
▪ A dual system exists for registration of real and movable property ▪ The requirement of a "technical passport" for initial registration is unreasonable and unnecessary, adding to costs and processing time ▪ Ownership of property is uncertain due to poorly organized registries ▪ The title registration system is not self-funding and receives insufficient funds from the budget, deteriorating facilities, limiting staff training and system upgrading, and opening it up to corruption
Recommendations
▪ Enforcement Law and Practice: a new system is needed to provide for efficient, effective, timely and reasonably low-cost seizure and sale of movable and immovable property to support secured financing ▪ Registration Update: once the registries are upgraded, it may take a long time to update ownership records; unless the process can be sped up, it is important to prioritize record updating ▪ Taxation and Registration: taxation of transfers, mortgages, and other transactions is having a strong negative impact on secured lending and registration, transfer taxes should be reduced to avoid market distortion ▪ Education and Training of Users and Administrators: why and how to register, enforcement.

5. Taxation

Taxes are a cost. Businesses pass tax costs to their customers through increased prices or absorb them by reducing other operating costs. A seller that cannot absorb tax costs will be unable to compete with those who can, and will ultimately fail. With typically limited resources, SMEs need affordable taxes based on a tax system that is economically efficient, with rational, fair and predictable tax policies. In addition, this system needs low costs of tax administration (for the state) and compliance (for economic agents), to encourage legal operation.

All taxes affect business growth and competitiveness, requiring a delicate balancing act. Taxes affect business both directly as an added cost, and indirectly through the tax impact on the economic health of the market. Government can stimulate growth and improve national competitiveness by keeping overall tax rates low. However, it faces the same challenge as business: to balance costs, risks and revenues to ensure sufficient funds are available to operate. Tax revenues are not simply a matter of rates, but of applying taxes to the largest possible pool of taxpayers. Taxes must be set equitably and without inappropriate exceptions for some taxpayers at the expense of others, otherwise the market becomes distorted through unfair competition based on inequitable tax burdens. Ultimately, taxes on business are borne by the consumer through higher prices or lower services. Excessive taxes lead to business failure, especially among SMEs, which also has an impact on consumers and employment.

Under the recently abolished Tax Code, SMEs reported labor (73% of those surveyed), profit (38%) and VAT (33%) as the most oppressive taxes and indicated that the response time and lack of clarity from tax authorities were major compliance hurdles. Some have recommended the elimination of all social contributions as a way to encourage transparent job creation and boost legal business. This is over-simplistic, would in fact not result in full legalization of the labor market, and would clearly create many other socio-economic problems.

The introduction of a retail sales tax to replace the VAT system will similarly not work in Georgia. To discourage tax avoidance, rates must be low. But with low rates come low revenues, and issues of administrative return. While all retail sales must be captured for the tax to work, wholesales must be identified to be exempted, and exemptions must be administered and may be abused. This requires mature institutions and sophisticated administrators. Balancing tax rates and administration becomes a complicated exercise which often results in unstable or multiple rates, cascading taxes depending on transaction type, and significant administrative costs, none of which Georgia can afford. Experts agree however that the current VAT system in Georgia needs to be fixed. An improved system would have important implications for business and legalization, in particular of smaller economic units.

Supplementary to problems with the tax system is the lack of real provisions for appeal. First appeals are handled internally at the Ministry of Finance, and can then be raised to courts or arbitrators. Tax authorities are unable to stop these proceedings from being started, but have much power to influence progress and outcome. Moreover, while the burden of proof rests in principle with the tax authorities, the law is not entirely clear in this provision, exposing smaller claimants to much pressure.

Radical recent changes to the Tax Code of Georgia have yet to show their impact on SME performance[2]. The number and level of rates applicable to entrepreneurial activity have been significantly reduced, but there have been no attendant changes to tax administration. As a result, problems with interpretation of certain rules and calculation of tax base values remain. Information asymmetry in favor of tax inspectors is likely to continue abuse of power, possibly to the extent of SMEs paying more in bribes to get rid of inspectors than they are actually liable to by law (as was observed under the old regime).

The new Tax Code provides few breaks for SMEs. Article 168 allows for exemption of income tax only, and only for physical persons (entrepreneurs) who do not use hired labor *and* are engaged in 24 defined (and limited) activities *and* use limited space[3]. This last limitation on physical space restricts business expansion and gives incentives to divide one enterprise into smaller units without economic motivation. Such rules may in fact curtail SME graduation into bigger businesses and limit SME development. Georgia also operates a system of voluntary registration for Value Added Tax (VAT) for businesses with turnover under GEL 100,000 (Article 222-224). Such a system simplifies tax management for micro-enterprises[4], while allowing them to register should their clients want to reclaim their VAT payments. However, the current system fails to provide for simplified accounting for SMEs, or to assume presumptive taxes which would simplify and decrease the cost of the system to both SMEs and Government.

Current SME Environment

- Tax yields have traditionally been low, due to difficulties in interpretation and high levels of corruption
- Target-based tax collection has raised problems of advance payments in the past
- In order to create a professional civil service, Government reduced the civil service by 30,000 in 2004 and used the salary saving to improve the wages of remaining personnel

- Streamlined number and level of taxes under the new Tax Code
- VAT system needs reform
- Too early to measure discretionary power of inspectors

[2] The new Code may influence SMEs both in their tax payment performance and in their legalization.
[3] This exemption is also available for certain physical persons employed in agriculture.
[4] The Law on the Support to Small and Medium Enterprises, reproduced at Appendix A, defines small enterprises as having turnover not exceeding GEL 500,000.

Recommendations

- Modernize Tax Administration: systemize audit, collection and enforcement functions
- Implement Tax Policy Reform: simplification of business tax obligations will only come with transparent, systematic and predictable rules and binding decisions
- Abolish Soviet Instruments, such as the "Official Tax Receipt" for business travel expenses
- Revisit Certain Taxes: property taxes might better be administered by municipalities under national legislation, taxes on property transfers should be dramatically reduced to eliminate undervaluation; income tax rates and administration can have significant impact on SME development
- Modernize Tax Service: to develop the concept of customer service in tax authorities and officials, while educating taxpayers about obligations, rights and recourse, to reduce information asymmetry particularly detrimental to smaller taxpayers and SMEs
- Upgrade Institutional Capacity: build the information, reporting and selection systems required for tax audit selection, informed tax audit, tax audit monitoring and performance monitoring; create central capacity to analyze the effect of any proposed tax before it is introduced.

6. Trade, Competition and Labor

Trade, competition and labor law also shape the business climate. Because of their size, SMEs are both less robust and more flexible. The choices Government makes, or fails to make, on facilitating trade, encouraging fair competition, and regulating the labor market have very implications for SME development and legalization. SMEs often operate at the margin, providing a very specific product or service. The ability to respond to the market determines many business choices. For example, prohibitive customs duties would encourage smuggling, while heavy labor restrictions would maintain employees in precarious positions.

6.1 Trade

Trade laws affect SMEs in a variety of ways. First, regional and international trade agreements lower the barriers to cross-border markets and effectively increase the overall size of the market being served: the Georgian market consists of only a few million relatively poor consumers. With access to neighboring markets, investors have access to more than 200 million potential consumers in the bordering countries alone. This provides tremendous revenue growth potential, but also requires the adoption of certain business tools to ensure competitiveness of local products in the broader markets.

In Georgia as in many other countries, there is a reluctance to liberalize the trade regime. Many feel that opening the country up to foreign products is harmful to local producers as it exposes them to undue competition. This can be especially difficult for transition economies, where the culture of competitive business is underdeveloped: the idea of a captive market remains, with entrepreneurs having limited vision (or skill) to grow the customer base by refocusing products, improving service or quality, actively targeting consumers. From a social viewpoint, it is also argued that smaller businesses provide essential jobs and overexposure to competition threatens these. These arguments are flawed, and it is important to remember that in business, the consumer – a very poor one on average in Georgia – pays for reduced competition, which increases inefficiencies (i.e., costs), narrows choice, and limits growth (jobs).

Trade regimes cover many other aspects, including investment and issues of intellectual property rights, including patents, copyrights, and trademarks. Without protection of these rights, SMEs have little incentive for research and development. In Georgia, there is a recognized potential for innovation, whether based on strong, Soviet-inherited science and engineering skills or on buoyant local artistic talent. To realize this potential, it is important to provide SMEs with guarantees that their unique products will be protected from commercial theft. This is particularly important in a context where the commercialization of ideas is still a nascent activity. The protection of intellectual property rights in turn impacts investment performance, as newcomers are unlikely to enter a market where their rights are not secured. And an actual, consistent investment policy can help Government attract investment (local and foreign) by establishing clear rules of engagement.

Trade policy imposes all these choices to be made, forcing Government to systematically analyze where it wants to take the country, and how it intends to get there. To develop business, especially SMEs, certain decisions about imports of raw materials and equipment which are in short supply in Georgia, will also need to be taken. High import tariffs and complicated border-crossing procedures make access to inputs and technology at best expensive, and constrains the ability of SMEs to maximize their resources. Special facilities for access to inputs and technology for SMEs might be explored, but a careful balance will need to be struck between easing access and the administrative complication of exemptions or separate systems, as these open the door to abuse and necessitate more inspection capacity.

At any rate, the need to rationalize and make transparent customs procedures in Georgia is widely acknowledged. Border-crossing is a tedious exercise, requiring much time, documentation and money. The system is inconsistent and unfair, as well as antiquated (in particular in valuation and risk assessment). Such a setting is always more detrimental to smaller players, and SMEs have less ability to tackle customs complications than larger business, often forcing them into illegal processes.

On the export side, Georgia has much to do on standardization (see II.2 above) which affects potential. Standards are guidelines that simplify trade, in particular by making the rules clear and equitable for all producers. In modern markets, mandatory standards to ensure health and safety are the only ones controlled by governments; voluntary standards are characteristics over-and-beyond which producers choose to offer their customers. Both need to be verified, but compliance testing and compulsory certification is necessary only for mandatory technical regulations. In Georgia, all standards must be approved (an impossible task) and all products must be tested for all standards, by law. In practice however, there is no capacity to do either properly. This is recognized abroad, so that Georgian exports will have to undergo – and pay for – testing twice: once in Georgia and once to enter their destination market. This complicates exporting and increases costs significantly, likely pushing SMEs out.

Current SME Environment

- Artificial barriers aiming to provide protection to a small number of producers prohibit free trade operating according to market forces
- Customs procedures are unnecessarily complex and cumbersome
- The requirement that customs clearances be processed through a broker adds costs and time to the process
- Georgia lacks understanding of the purpose and impact of trade regimes in a market-based economy
- Expensive international transport hampers exports

Recommendations

- Public Education: to familiarize the population, Government and business (esp. SMEs) with the advantages of freer trade and increased competition; to build support for trade agreements
- Capitalize on Existing Agreements: to reap the benefits of membership in the World Trade Organization, of the European Partnership and Cooperation Agreement, and regional trade agreements
- Customs Service Reform: to redress information asymmetry, which costs SMEs greatly by not giving them access to predictable, transparent application of published tariff rates and inspection; to create a public-private partnership for trade maximization
- Border-Crossing Simplification: many procedures can be streamlined or abandoned altogether, especially for smaller shipments (risk assessment)
- Remove Testing and Certification Requirement for Exports.

6.2 Competition

SMEs face competition of two types. First, SME success depends on their ability to serve the market by providing acceptable goods and services at reasonable prices. Fair competition drives down costs to consumers (including SMEs themselves who need low cost inputs from their suppliers) and improves services. Competition eliminates businesses that cannot make necessary adjustments to their rivals' competitive strengths, and helps SMEs lower their costs and increase their efficiency to better compete in global, regional and local markets.

Second, is unfair competition. For SMEs in transition economies, this comes from two corners. Abuse of dominant position and use of unfair trade practices (such as price-fixing) allow misuse of power to keep new entrants out of the market or drive out existing competitors. These problems are normally addressed through competition laws, which ensure a “level playing field” for all market participants. In Georgia, the impact of utility monopolies on SMEs should also be noted, whereby their dominant position results in poor service for high prices. Unfair competition can also come from illegal activity, such as bribery of officials and informal business. These reduce costs for tax and compliance evaders, enabling them to substantially undercut the price of formal sector competitors. Unfair competition undermines the ability of SMEs to enter or maintain markets by cutting their revenues and sometimes raising costs. If the risk of unfair competition is high, formal SMEs are unlikely to undertake the expense of developing a market at all. This has a negative impact on legalization, tax revenues, consumer protection and economic growth. In Georgia, the high cost of doing business in the formal sector continues to compel informal activity as a survival strategy. The relatively low purchasing power of the market further supports such move.

Current SME Environment

- By avoiding the costs of taxes, fees, registration, permits, labor regulations and other burdens, informal SMEs substantially undercut formal SMEs in some markets
- SMEs complain about unfair competition – the current costs of formal business are too high, and informal activity has become a survival strategy
- SMEs also complain about fair competition, suggesting a lack of understanding of the benefits and impact of open competition
- SMEs face barriers to operation on a par with large enterprises (corruption, unclear legislation, lack of experience in marketing and export, low access to finance) but have fewer resources to solve these
- Utilities are unreliable, limited and expensive

Recommendations

- Competition Framework: to develop competition laws and anti-monopoly capacity based on the population at large, Government and business understanding the advantages of fair competition, in particular for small business protection and development
- Identify Unfair Competition: to ascertain what types of unfair competition SMEs are subjected to and design appropriate regulatory and enforcement tools
- Utilities Pricing: frequently reported as much too expensive with sporadic service, preventing SMEs from absorbing the costs effectively; to increase competition in this market over the longer term, in the shorter term to regulate pricing to emulate competitive pricing (including preferential rates for SMEs).

6.3 Labor Market

Labor costs must reasonably reflect productivity and be recoverable under competitive prices. When labor costs are too high, SME growth will be stunted, which results in fewer jobs. When costs are lower, SMEs are able to hire more employees if necessary. SMEs do not see increased employment as a goal – that is a social goal pursued by policy makers – but as an option to be exercised only when justified and demanded by market conditions.

There are several types of labor costs. First, minimum wage and social contribution requirements determine the affordability of each new worker. From an economic perspective, higher wages should be related to higher productivity. Where these costs (wages plus contributions) are out of line with labor productivity, this results in lower profitability in SMEs and lower employment in the formal sector overall. Second, labor regulations have a cost. Many SMEs face seasonal demands that require flexible labor numbers. If they cannot hire temporary labor or must pay excessive severance pay upon dismissal, SMEs will not be able to adjust, they will miss opportunities or turn to the informal labor market (making employment precarious). Third, education and training affect labor productivity. If education is disconnected from economic reality, employers bear the increased burden of education and training, often putting them at a competitive disadvantage with neighboring countries or the international market. Finally, labor unions can have a negative impact on overall employment, when they do not balance legitimate demands for proper working conditions and benefits against the realistic ability of the market to absorb the costs (unions raise the bar across sectors and thus impact all business, including SMEs).

In Georgia, the Labor Code fails to mirror new labor relationships based on private agents, rather than the state. It does not clearly define the duties and rights of either employee or employer, and fails to provide for violations. These shortcomings contribute to informal employment, in particular in smaller enterprises. Most SMEs do not use employment contracts, and none list salary when they do. Its is rare for SMEs to advertise for recruitment, preferring to rely on friends and relatives – a further way to avoid formal parameters.

Current SME Environment

- Many existing SMEs are traditional, low-skill, family businesses, with mostly informal employment
- Many informal workers understand that they will lose their jobs if they insist on full legal rights, but do not feel these advantages can be truly realized in today's setting and therefore choose to forgo them
- Georgia still enjoys a well-educated workforce, but its skills and business attitude do not support modern business development or SME entrepreneurship
- Several donor programs address business management education

Recommendations

- Pay and Productivity: to develop an understanding of the relationship between labor costs, productivity and pay (and social contributions), aiding SMEs to legalize employment
- Labor Reform: to make the system more flexible and allow for easier entry and exit from employment, which will reduce costs, increase job security and boost skills development
- Public Education: to overcome the disconnect between work and compensation inherited from the socialist system, to encourage performance based rewards, and in the long run to allow for reallocation of wasted resources to a more effective social support network.

III. SME ACCESS TO FINANCE

SMEs, whether start-ups or existing entities, need either capital or access to working capital to be able to grow. Capital can be in the form of internally generated funds (such as profits or retained earnings in the company) or external funds such as a capital contribution of some type. Working capital can come from a number of sources, including loans, credit extended by suppliers, sale of assets, or internally generated profits. Capital in most start-up SMEs comes from the individual owners or stockholders of the companies, and may consist of money contributed by friends, relatives, other entrepreneurs that believe in the company, and in some instances from investment companies. However, in the vast majority of cases it is contributed by the individual entrepreneur, and his family and friends.

Loans can be for long or short terms. In most instances, short term loans (under one year) are referred to as "working capital" loans, and for periods longer than a year they are referred to as term or long term loans. These terms are in a broad sense common, but can be misinterpreted and used incorrectly, and their only purpose is to generally categorize financial information. Loans can be made by lenders, friends and relatives, other suppliers, other individuals or investors; and most are evidenced by a note or contract with a promise to repay.

Virtually any lender in any country makes loans based on the availability of funds and the risk involved. The availability of funds is quite simple: either they are available or not. Risk on the other hand is a subjective decision arrived at by the lender based on a number of aspects, but the primary one is the existing credit and operating history of the borrower. In a start-up operation, there is no history, and thus lenders around the world are extremely hesitant to lend to start-up operations. There are exceptions, but this is generally the rule. For start-ups, the entrepreneur has to bring or attract enough capital to start and run their operation for some period of time before trying to borrow funds.

In some countries, **investment funds** (which are not related to what in the West are called venture capital funds) provide capital or loans to start-up or existing companies. These funds normally require an ownership position based on the relevant amount of money they are contributing to the company or venture. By taking an ownership role in the company and possibly a director's position they are on site to view the company's operation from the inside, and are at the same time able to provide the company with management and technical assistance if the company needs it. An investment fund dedicated to SMEs can be an excellent addition in an emerging market to assist start-ups and existing companies that need and deserve capital and technical assistance that is unavailable elsewhere.

For Georgia, strong symptoms exist that point to an underlying problem. All business representatives interviewed expressed as their primary concern that loans for working capital and new investment are difficult to get. In addition, SMEs feel that rates are too high. SMEs list family or individual capital as their primary source of funds, with approximately three-quarters relying on this source for working capital and new investment. This heavy reliance on personal sources of funding is in great part due to a perceived or actual inability to obtain affordable financing from banks, microfinance institutions (MFIs), leasing companies, and other institutions that provide loans or credit. The community of financial institutions disagrees, however. Bank and MFI general managers cited lending programs that exist in the market place to fund inventory, capital expenditures, and even start-up businesses . The major obstacles lenders cite include getting funds into the rural communities and educating the public that financing is available. There is also an acknowledged distrust of banks and confidentiality provisions, especially as concerns tax authority scrutiny. On the other hand, Georgia has a credit culture, where borrowers do fully expect to have to pay back the loans they take out.

1. Bank Competition and Access to Credit

The banking sector is widely considered to be the most developed and robust of Georgia. Recent months and years have seen a concentration of banking institutions due to increased capital requirement and more stringent National Bank operating rules. Experts agree that the proliferation of very small banks was not a sustainable nor indeed desirable situation: rationalization of banks through concentration is considered to be part of natural evolution towards a modern, competitive banking sector. The impact on SMEs has yet to be determined, but some suggest that it will be detrimental:

> Theory makes ambiguous predictions about the effects of bank concentration on access to external finance. Using a unique data base for 74 countries of financing obstacles and financing patterns for firms of small, medium, and large size, Beck, Demirgüç-Kunt, and Maksimovic assess the effects of banking market structure on financing obstacles and the access of firms to bank finance. The authors find that bank concentration increases financing obstacles and decreases the likelihood of receiving bank finance, with the impact decreasing in size. The relation of bank concentration and financing obstacles is dampened in countries with well developed institutions, higher levels of economic and financial development, and a larger share of foreign-owned banks. The effect is exacerbated by more restrictions on banks' activities, more government interference in the banking sector, and a larger share of government-owned banks. Finally, it is possible to alleviate the negative impact of bank concentration on access to finance by reducing activity restrictions.[5]

In the US, bank consolidation initially restricted the access to credit of smaller borrowers, with "mega-banks" focusing on standard products and the high end of the market. Supply then swung back with the emergence of small, client-focused banks which concentrated on quality services for smaller borrowers. For this to happen however, a robust framework for secured transactions, supported by credit information bureaus and moveable property registries, is necessary.

In Georgia, there is a sizeable non-banking financial institutions network also, in large part supported by donors. This may address some of the concerns raised above. Most of these programs were designed to target one group of potential borrowers with specific characteristics, and many have evolved with borrowing mass and type as well as with increased competition.

2. Direct Access: Banking and Debt Markets

There are no debt markets, secondary markets, or a viable stock market in Georgia. Some state-owned enterprises are considering bond issues, including the railways, Tbilisi municipality and a telecom company. Nevertheless, even if these facilities were available, almost no SMEs would normally have access to them. The following is a review of SME alternatives in today's Georgia.

As mentioned above, basic lending is built on the availability of funds to lend and the risk involved. However, for regulated banks, both fund availability and risk take on additional aspects that need to be discussed further. In Georgia, as in most post Soviet countries banks have had the initial attitude that they only wanted to deal with the large clients that had some type of a credit history that they could access. Thus, it is easier to make 10 - $1 million loans than to make 100 - $100,000 loans, or a 1000 - $10,000 loans. This is true to an extent, but does nothing for spreading risk, and costs more to

[5] T Beck, A Demirgüç-Kumt and V Maksimovic, Bank Competition, Financing Obstacles and Access to Credit, World Bank Research Working Paper 2996, March 2003

administer. This attitude is slowly changing as there are fewer large loan customers to attract, and those larger customers now set their own terms and conditions for loans – thus the interest rate on these loans is substantially lower than an SME type loan.

Also, because of **EBRD**, **World Bank**, and **IFC** loan programs and investment in some of the Georgian banks, the banks are changing their attitudes towards SME lending. There has also been increased competitive pressure, for example from one of the original micro-credit banks (ProCredit),which has been taking an important market share away from the traditional banks by making SME loans on a profitable basis. Thus, there is now some competition for SME loans, and at the same time some of the lenders have proven to the banks that these loans are profitable, and can spread the overall lending risk for a bank into a broader base.

Bank loan sizes

TBC Bank makes micro-loans from $1,500 to $15,000 and small to medium loans from $20,000 to $100,000. Its main target are the larger loans, though regional branches have up to 60% in micro-loans.

ProCredit Bank differs by policy from other banks, focusing on micro and small business. Its main portfolio is in the $1,000 to $20,000 range. The bank also extends express loans for $200 to $1,000 for micro-business.

United Georgian Bank and **Bank of Georgia** have loans from $1,00 to $150,000. In regions, small business is the target market and makes up close to 100% of portfolios. BoG based its regional expansion on small lending.

Eurasia Foundation, May-June 2003

On the demand side, specific borrowers' problems include:

- Long lead time between application and disbursement: decisions may take only 3-5 days, but documents require up to two weeks, a long time in SME terms.
- Centralized decision-making: although there is an extensive branch network inherited from Soviet times, all decisions are made in Tbilisi head offices, removing the decision from the local setting, and increasing costs and delays.
- Oversecuring of the loans: because of the lack of risk information, heavy collection costs in case of default and National Bank stringency (which makes lending beyond 60 days risky), banks are overly cautious and demand two to three times collateralization; in some cases, this is done for consistency even when the project is sound and the borrower well known.
- Bank policy: some reports indicate that certain projects fail to be financed not because they are not viable, but because they do not correspond to the solicited bank's field of interest – and there is no information about where else to apply.
- Some observers suggest that more binding banking practices should be introduced to better secure borrowers interest.

The availability of funds for Georgian banks is simple and complex at the same time. Generally, most Georgian banks have excess funds to lend at present, and are actively seeking borrowers. However, these banks do not lend on a floating rate basis, but are confined to making fixed rate loans. The funds used for lending can be defined as demand deposits, meaning the customers can withdraw their funds with little or no notice to the bank, and at the same time the banks are paying "floating" rates based on the market for these funds. The deposits are almost never left in the banks for terms longer than about 13 months. So if a bank wants to make a two- or three-year fixed rate loan, it has to worry about the fact that its deposit customers are demanding market rates on their deposits that can change from day to day, but it is locked into a fixed rate loan – and the other side of this is that the banks customers can withdraw their money at any time. Banks can and do work around these problems, but they are a critical aspect to increasing their lending.

On the credit risk side, Georgian banks lack a number of basic and critical tools to extending loans:

- There has not been a Credit Information Bureau in Georgia to ascertain the credit history of a borrower or potential borrower. A Credit Bureau was recently established, but it will still be several months before it is fully operational.
- A number of bank loan officers and administrative staff are not trained and skilled in making SME loans.
- Conversely, most SME borrowers are not skilled in the proper method of seeking a loan and supplying the bank with enough quality financial information and plans.
- The banks lack a number of legal tools that allow them to make the type of loans SMEs needs, such as a good Secured Lending Law, Moveable and Immovable Property Registries, changes in the Mortgage Lending Law and the Bankruptcy Law, the ability to non-judicially enforce their rights, etc.
- Courts and procedures required to adjudicate lending disputes are sometimes corrupted, and almost always a very lengthy and costly method of enforcing the banks' rights.

Current SME Environment

- Restricted access to credit is limiting Georgia's ability to acquire modern equipment and technology and consequently constrains productivity and economic growth
- Georgia had no credit information bureau, making it difficult for lenders to assess the risk of borrowers, forcing entrepreneurs to rely more heavily on personal relations and collateral to access credit
- Most lenders approve loans based on the "name" of the borrower, the value of the collateral and the number of guarantors, rather than analyzing the business's ability to generate sufficient cash to repay the loan
- Bank still work high collateral requirements: two or three times the loan amount
- While creditors and investors have strong legal rights, Georgian courts are inefficient, resulting in poor enforcement of these rights, constraining SME access to capital
- The cost of enforcing a contract in Georgia is almost twice that of Armenia and three times that of Ukraine, the average time is 375 days for resolution of a dispute
- Interest rates have decreased in recent months but are still seen as too high
- It is unlikely that the Georgian economy will ever be large enough to justify a stock market

Recommendations

- Define Lending Needs: to better establish local requirements and match or design policies, programs and products to SME needs
- Upgrade Lending Skills: to make banks more proactive in market-based lending in changing conditions, to develop more modern attitudes towards performance banking
- Market Segmentation: to develop better suited lending, in particular for agriculture related lending
- Upgrade Borrowing Skills: to help SMEs better manage finances, understand different financial situations and tools, build relationship with lenders, and apply the right financing solution
- Strengthen Remedies: to facilitate recovery of bad loans and lower risk and costs
- Public Education: to develop a trust in the banking system and provide a broader base for lending and borrowing.

3. Direct Access: Microfinance Institutions

MFIs are almost always created artificially with donor money, as without this input there is no way to start these types of lender. In developed economies there are few MFIs because banks and others lenders take care of this specialty market and if not, regulators put pressure on the banks to fulfill this need. One of the advantages of MFIs, besides addressing the needs of micro and small borrowers for finance, is that they have contributed to legalization.

There are a number of MFIs in Georgia that have had various types of support and funding. It appears that these MFIs are not yet self-sustainable, require funding at below market rates, and still need to develop further. Technically, MFIs are not presently operating according to Georgian law, because their status is not adequately established. Georgian MFIs are prohibited from accepting deposits, but even if allowed, it is assumed that the operating requirements would be prohibitively burdensome, and it is not clear that anyone would deposit funds into MFIs.

The **Georgia Microfinance Stabilization and Enhancement** project constitutes USAID's major involvement in this field, providing funding and technical assistance of up to $10 million over four years. MFI portfolios are still largely trader based but moving towards small scale production and services, which changes the loan products and reduces MFI risk by diversifying the debtor basket. The average loan of GMSE backed MFIs has increased from $500 to $1,000 in one year, and the lending rates are closer to the banks' than in Russia because the market is more competitive: initially, MFIs pressured banks, now the banks have caught on, and a virtuous circle is begun. GMSE has five official partners, to whom it provides technical assistance, out of 11 recognized MFIs in Georgia, all of which are invited to attend training along with banks. GMSE is working to revamp MFIs' products and services, and provides supply side upgrade to support product changes. Since November 2004, GMSE has been encouraging MFI-bank partnerships to expand the product range, and Credo (formerly World Vision) and the People's Bank in Gori are early examples. GMSE does not work on the demand side. Business centers in Batumi and Kutaisi are trying to do so, but focus on drafting business plans which is not a sustainable activity. Successful demand side project elsewhere have focused on assisting SMEs in finding sales and contracts that can be used as collateral, well beyond the traditional business plan/loan application model[6]. GMSE has recently published a plain-language corporate governance manual to promote modern business concepts of mission, vision, values, roles and responsibilities.

The **Small Enterprise Lending Programme** (SELP), co-financed by the EBRD and TACIS, provides technical assistance and on-lends to four banks (Bank of Georgia, United Georgian Bank, Tbiluniversal, ProCredit). Through these, it finances approximately 6,000 clients and over $12 million (at less than 1% risk over 30 days). The average loan term is 15 months, the maximum two years. The average size has fallen from $5,000 to $2,000, in part because the floor has been lowered from $1,000 to $200 (while the ceiling has been upped from $20,000 to $50,000). The banks give both individuals and individual entrepreneurs – there is little distinction in borrowers' minds – and cover all sectors. SELP is downscaling the banks' clientele, moving them away from collateral to cashflow based lending, in line with the EBRD's poverty reduction aim: loans must be commercially viable and development oriented. Technical assistance has centered on increasing efficiency of existing operations and branch expansion (from three to 17). SELP supports micro-lending units in existing branches and service centers, and assists established banks which inherited state branches to increase productivity. SELP has over 110 staff under training (70% loan officers, the rest management and support), all of whom are new hires over whom it retains choice: SELP introduces the business concepts of merit and performance based bonuses. The Programme estimates it has increased its banks' share of the SME lending market from 3% to 15% as a group; providing express loans unsecured with real estate or obligatory gold, fast delivery, and lower loan minimum. SELP retains veto power over its on-lenders' borrowers.

Current SME Environment
▪ MFIs are funded by donors ▪ There are some unresolved legal issues with MFIs ▪ The current legal structure does not permit MFIs to accept deposits

[6] See for example the USAID funded PRA project in Peru.

- MFIs are not serving rural areas as effectively as desirable
- Micro-enterprises need exchange services, Western Union-type money transfers and credit cards, and underuse deposits
- MFIs play an important education role on loan products but do not do so systematically

Recommendations

- MFI Sustainability: to give MFIs the right to take deposits, and to help banks understand MFIs and take position in them, thereby reducing unnecessarily high rates and collateral requirements, and potentially developing better suited instruments for SMEs
- Public Education: to expand the scope of MFIs and address lending into more rural areas as demand grows.

4. Direct Access: Leasing

There is no equity financing to speak of in Georgia today; at the same time, agricultural risk is commonly overestimated. Leasing offers potential borrowers a very useful method to obtain much needed equipment and other assets. Leasing considers assets from the user's point of view: it does not matter who owns it, so long as he has use of it. Leasing gives access to technology without requiring large cash outlays or extra collateral, freeing up limited SME resources. Because the equipment is the collateral, and equipment can be amortized, there is the possibility of lower repayments than on a bank loan – one pays "interest" only on the part of the "capital" one uses. Leasing can also be made to suit seasonality of cash flows, sustains access to up-to-date technology, and thus reduces the cost of maintaining equipment.

Leasing is the only financial instrument designed for the long term: the average term is 35 months. But leasing companies do not take deposits, they raise capital through debt and equity. In Georgia, this is from donors, though some has been on a commercial basis: **OPIC** has lent $1.5 million at 9%, the IFC is considering another loan. Georgian leasing companies are well capitalized and leverage at 3 to 1 (it is argued they could support 5 to 1, while in the US it is 15-1). Leasing capital has increased dramatically in Georgia in the last 18 months. Yet leasing is a new, undeveloped and unproven finance tool for Georgia. It is not well understood, in particular by policy makers. As a result, there are problems with the legal definition of leasing and its taxation.

AgVANTAGE has been developing the leasing industry in Georgia under USAID funding. This industry is principally constrained by two hurdles: lack of understanding of leasing, and thus a poor legal framework for leasing activity. There are some basic misconceptions in policy-makers' minds about what a lease is and how it works, reinforced by inadequate legal definitions, which lead to an unfavorable (possibly unworkable) setting for leasing. AgVANTAGE has prepared a Law on Leasing which includes all modern best practices, which **GEGI** will be promoting. AgVANTAGE has also been raising awareness of leasing as a financial tool in the community, and helped broker some deals. Significant potential demand for leasing in Georgia has been established by both AgVANTAGE and the **IFC**. The new Tax Code fails however to recognize the peculiarities of leasing as a financial instrument and thus taxation is inefficiently applied.

Current SME Environment

- Georgia's leasing industry is young but growing, despite the lack of a leasing law
- Vehicles (private cars, commercial vehicles, and rolling machinery) account for the majority of leasing transactions, equipment and other machinery leases make up the remaining portion
- Taxation is incorrectly calculated on leasing

Recommendations

- Harmonize the Leasing Law: to ensure the legal framework accommodates a workable law on leasing (property ownership, registration, securitization and foreclosure)
- Taxation: to amend the Tax Code to properly tax leasing transactions, otherwise undermining the value of leasing to SMEs
- Public Education: to better understand the advantages and availability of leasing for SMEs in market segments not reached by commercial advertising
- Micro-leasing: in more remote areas of Georgia, micro-leasing may be best suited, but this is a new instrument and there is little experience worldwide.

5. Indirect Access: Loan Guarantees

5.1 Indirect Loan Guarantees

Indirect Loan Guarantees (ILGs) are usually provided in developing and emerging markets by international donors or international financial institutions (IFIs). These guarantees are used to promote certain types of loans or lending, such as lending to SMEs. Governments can also institute guarantee programs for SMEs. These types of guarantees can help jump start lending to the SMEs by inducing lenders into this market by substantially reducing their risk.

Operational ILGs are not developed in Georgia, though there is a **MIGA** facility at the United Georgian Bank. Government has also approached the World Bank, asking it to offer a guarantee to mitigate the risks of privatization, but there are questions of central versus local government ownership and thus over debt (this may be particularly relevant to SMEs). USAID's **DCA** Program is available subject to the local mission's participation and involvement, along with a bank or other institution's involvement. At the present time, USAID is looking at the possibility of developing a program with one or two banks in the DCA program for rural development. While not directed specifically towards SMEs, it could be used for this purpose, especially given the mean size of businesses in rural areas.

The critical needs for ILGs would be additional donor or IFI support in this area, or the development of one or more USAID DCA programs for SMEs.

5.2 Direct Donor or IFI Funding

This is funding provided to banks or other lenders by donor or IFIs that the receiving banks or lenders then on-lend to a specific type of borrowers. **IFC**, the **World Bank**, and **EBRD** have several programs in Georgia that are doing this. These types of funding also jumps start the lending in specific areas, and when done with several lenders at the same time, promote competition among the lenders.

The World Bank operated 50 credit unions in the rayons, up to Kobuleti's GEL 150,000. The experience has been mixed, with very rapid expansion not well supported by a too-small Tbilisi office. Some of the unions were mismanaged, some failed because there were no real opportunities in their localities. The World Bank gave grants to start these credit unions, but required some savings. The Bank has two other facilities: the Social Investment Fund, which combines grants and contributions, and the Municipal Development Project, which is bigger and is based on loans, to support the repair of local infrastructure according to local priorities. Each fund amounts to approximately $15 million.

The Ministry of Finance and Economy of the **Adjara** Autonomous Republic is working on the elaboration of an Economic Development Support Program for the region. The program envisages participation of the Ministry of Finance and Economy of the Adjara Autonomous Republic, commercial banks and entrepreneurs. The program is expected to last to the end of year 2005 and foresees subsidization of bank loans of entrepreneurs, both start-ups and operating, that are established according to Law of Georgia "On Entrepreneurial Activity". The workings of the program are somewhat unclear. The Autonomous Republic's budget allocates GEL 1 million within the framework of the Program. The Program envisages provision of subsidies in the range of GEL 1,000-60,000 and up to 30% of the total amount of credit. The time period is from 6 months to 3 years. Should the credit become problematic, the bank would have to pay back the amount of subsidy to the state.

The critical needs for direct donor or IFI funding is additional participation of funding sources, and continuing funding for the existing projects until such time as the lenders can operate on their own.

Current SME Environment

- Banks have money to lend, but still view risk as high generally, especially for SMEs with no track record
- There are no loan guarantee programs for SMEs in Georgia
- There are several successful onward lending programs

Recommendations

- Loan Guarantee Assessment: to establish the need, value and sustainability of a loan guarantee, commercial or Government-backed
- French-type Startup Loans: to offer startup loan as a mix of state-guaranteed and commercial bank loan, as introduced by the Banque du Développement des PME in 2000, which reduces banks' perceived risk
- Information Database: to capitalize on the numerous donor programs in lending and better provide macro, SME-specific instruments
- Development Bank vs. APEX: to select the best structure to specialize in certain debt guarantees, and introduce new performance-based discipline in lenders.

6. Indirect Access: Insurance and Pensions

Insurance companies and both public and private pension funds in the West are an important source of both capital and loans. Although there seems to be little evidence or information on these groups providing funding directly for SMEs, it is possible. However, in Georgia, the insurance industry and pension funds are relatively undeveloped, and constrained by law. The insurance industry is young and growing, but needs both maturity and the legal ability to place any of its funds into lending or investment: it is tightly restricted as to where it can place excess money – bank deposits and Georgian Treasury Bills are virtually the only place for investing insurance funds. Insurance industry development is also constrained by a low understanding of the value of insurance, both individually and socially. As regards pension funds, both the public and private systems are in dire need of complete restructuring before they will even operate efficiently and meet their mission, let alone can generate funds and capacity to lend or invest.

Current SME Environment

- The insurance industry is in its infancy in Georgia. There are few market-driven products available that normally support finance in developed markets, such as credit risk insurance or hazard insurance
- There is reportedly very little trust in domestic insurance companies
- Insurance in Georgia still suffers from inherited Soviet-style quirks which do not suit modern operation

- Due to the weak status of the pension system in Georgia, life insurance is being used as an alternative to long-term savings normally accumulated in private pension funds
- Georgia needs profound, long-term pension reform – it will be some time before pensions become financiers

Recommendations

- Insurance Framework: to significantly reform and develop the legal and regulatory framework necessary to attract quality insurance offerings
- SME Insurance Awareness: to supplement commercial advertising and educate SMEs on using insurance to lower business risks
- Develop Debt Markets: to allow insurance companies (and later pension funds) better outlets for their funds, rather than push them into investment opportunities outside the country or in areas other than sources of finance for SMEs
- Pension Reform: to overhaul the pension system of Georgia, which may some day become a support to SME development.

IV. COMPETITIVENESS

Revenue potential increases when SME management and staff have the necessary education, training, information and knowledge to run the business effectively. SME managers need these skills to understand the market, control internal costs, and identify new opportunities. In other words, a profitable SME or SME sector depends greatly on its investment in human resources through appropriate service providers, organizational affiliations, and linkages. In a developed economy, an entire infrastructure of companies provides human resource development programs. However, in transition countries like Georgia, SMEs operate with more limited connections to other firms in their business sector, restricting the potential to improve their performance and compete in the market place. Businesses typically rely more on their political connections to gain market advantages instead of focusing on how to successfully compete. While political connections may help individual businesses in the short term, the benefits to the overall economy are few.

For businesses in a changing environment, ignorance is one of the greatest risks. SMEs avoid this risk by regularly upgrading the information, knowledge and skills needed to keep up with their competitors and the world around them. Another risk comes through using untried, unreliable services, in which the value of the services purchased is below the price paid, leaving the business in need of further investment in the same area. This is a market risk which can be mitigated through programs that certify the service suppliers for quality.

With input from the private sector, donors can design interventions in business support service markets that create faster development of the service web. Then SMEs could focus on improving their performance in the marketplace as a better option for business growth and profitability, increasing their regional and international competitiveness at the same time. Supply-side interventions include:

- Training for business development service providers
- Quality assurance and accreditation programs
- Introduction of new methodologies and technologies to SME professionals
- Technical assistance to business associations to develop a suitable service mix to build and sustain membership.

On the demand-side, sometimes services exist but at a cost that is not in line with current market realities. Donors can help connect supply and demand in the short-term. This gives the market time to adjust costs and pricing. For example, donor projects can provide:

- Assistance to management consultancy service providers so that they can lower their prices to an affordable level for SMEs
- Direct grants to SMEs to cover some portion of services at the existing price levels of service providers
- Sector-focused services that reduce individual costs through pooled resources
- Awareness raising programs on the benefits of business development services, so that SMEs understand that investment in such services will pay off through improved business performance.

With both types of interventions, the aim is to provide a temporary but sustainable stimulus, enabling the market to function more effectively without further intervention. Such interventions may lend themselves to donor sponsorship because of their temporary nature.

1. Supporting Start-up Businesses

Most start-ups cannot afford to pay for support services, especially in developing and transition countries. They hope that their basic level of knowledge and their initial resources will be enough. Often it is not. There is a high risk of failure in start-up businesses, which could be mitigated with start-up support. Because SMEs cannot afford the services they need, there is inadequate commercial demand in the market. Thus, no service industry develops to support start-ups, perpetuating a self-defeating cycle. Governments worldwide have decided to enter the market to fill this gap. They work with private sector service providers or through government agencies to subsidize information and training for businesses that cannot afford it. In the US and EU, governments promote a wide range of support services for start-up businesses, encourage self-employment and SME opportunities in areas of social or economic concern, and target growth in new markets. These government supported activities lower the costs of obtaining the knowledge and skills necessary for success, while developing the business services industry, including:

- Counseling on the decision when and how to form a business
- Information on the legal and regulatory environment
- Information and guidance on access to finance
- Grants or other low-cost finance
- Guidance on marketing and information sources available
- Referral to specific skill training that might be necessary before a business can be launched
- Support to develop basic business management skills.

In recent years, there has been an increase in the development of business incubators as well. These programs assist groups of new entrepreneurs, generally with a sectoral focus or demographic emphasis. Incubators often combine physical resources, such as low-priced office space with information resources, including internet access and business counselors. This creates a cluster of resources necessary for start-up success. Whatever their delivery features, from a SME viewpoint, support services reduce the costs of start-up allowing them to free some of their assets to pursue revenue opportunities, lower overall risks through better understanding of their business, and reduce the risk of failure due to ignorance.

In Georgia, numerous donor projects have provided some kind of business advisory and training services. They observe that the consumer, the entrepreneur, is not very sophisticated. Often, decisions are based on production, not on the market. "Most business do not know what business they are in." The training needed is for basic marketing, business and management skills in particular about sourcing and selling. There is inappropriate use of resources, in particular in agriculture and agribusiness. Many small workshops do not have access to machinery or to a viable market; scientists do not think commercially about their high-tech, low-cost ideas. SMEs are built on personal connections, so have very limited base. When applied to credit, these shortcomings entail creditors doing valuation and borrowers taking loans they do not need because they cannot calculate a project's effectiveness. Compounding this general lack of understanding of marketing, employee management, corporate governance, accounting and business analysis from a strategic perspective, is a reticence to recognize a need. Small entrepreneurs distrust banks, contracts, courts, suppliers, buyers, government and up to a point donors, and cannot let go of total control over their enterprise, even if this would be most beneficial.

There are no clear priority sectors for Government, despite several donor studies, including **GEGI**'s cluster competitiveness appraisal[7], recognizing tourism, agribusiness, and other niche markets as having high potential. The **UNDP** is laying plans to create business incubators in its 19 Business Service

[7] See www.gegi.ge.

Centers across Georgia. **Oxfam** is assembling a regional database (to cover Armenia, Azerbaijan and Georgia) on SMEs to promote linkages and synergy. According to the **Eurasia Foundation**, the absence of appropriate skills and experience is holding SME development back in Rustavi, Borjomi is mostly seasonal, Gori could be developed as a trade center, Kutaisi retains an industrial base and could be the hub for western Georgia development, while Poti SMEs depend completely on the port. The Foundation has extended three grants in tourism, to support GIS inventorying of architectural and recreational sites and develop a Georgia label, and one in Guria to establish a Citrus Growers Association to share information, resources and equipment.

One noteworthy experience comes from **KfW**, which started 40 SMEs four years ago by providing training to some 400 people and then giving free equipment and maintenance, though not finances, to establish surveying and geographic information system (GIS) SMEs. Each enterprise had between 10 and 15 employees. Today, 25 remain due to competitive consolidation of the market (this could be further reduced to only 10 larger SMEs) and operate regional branch offices. These SMEs compete for tenders both from KfW and from the BP pipeline project and other commercial clients. One of the enterprises started by the project now operates worldwide. KfW also started two soil evaluation SMEs that sell on demand, at present mostly to larger farms but some funding is available to develop small landowner demand, for plant selection and more importantly for land valuation for tax purposes. The total program is for $25 million over six years, its client is the Public Registry but has low absorption capacity for all the data being generated. KfW is also planning to work on access to banks in Adjara.

Current SME Environment

- Georgia's production capacity, geared to supply large inventories to end users/buyers in the former Soviet Union, is oversized for today's potential markets and its equipment is out of date and/or inoperable
- Some business start-up services are provided by donor programs
- MFIs and ProCredit Bank extend credit to newly formed businesses
- National and local governments provide little more than lip service to SME support

Recommendations

- SME Baseline: to profile the SME sector both formal and informal, including information on sectoral and geographic distribution, employment, and general market information on priority sectors
- SME Strategy and Policies: to elect a government champion for SMEs, evolve a strategy for the development of SMEs and provide funding to support this strategy
- Revive Support Network: to restore the SME Development Center to coordinate activities of the donors, local communities, business associations and others to ensure better SME policy implementation; to create a Rural Agribusiness Development Division in the Ministry of Agriculture to provide extension services
- Basic Start-up Services: to support donor programs and active associations in developing support for SMEs at the community level, exploring commercial and alumni sponsorships to grow the industry
- Workspace: to encourage business incubators and shared workspace in enterprise zones, shared service centers, industrial parks, office parks, potentially bolstering linkages
- Self-Help: to centralize information and coordination points to facilitate access, to provide schemes for self-assessment of business acumen and skills
- Public Education: to promote better understanding of SMEs and entrepreneurship and overcome bias and suspicion against SMEs and entrepreneurs.

2. Education, Training and Consultancies

For SMEs, ongoing education and training of management and staff are essential to stay competitive. This has a direct impact on the costs, risks and revenues that SMEs must balance for their success.

Learning starts with formal education, including vocational schools. Other programs then build on this education by providing continuing education for new and improved skills. Lifelong learning thus requires a variety of providers offering courses, seminars, workshops or even one-on-one assistance from consultants. Continuing education is a crucial part of keeping up with the rapidly changing business environment. New approaches, new markets, new strategies, new trade relationships and a host of other changes mean that SMEs must regularly update their knowledge and skills to avoid the risk of obsolescence. But education and training must be designed to enable recipients to meet the challenges of their market: competitiveness is not based on having the best education, but on relevant education that graduates can readily apply in the current environment.

In Georgia, where the general population is well educated, the costs of basic education are not borne by business, and the cost of initial on-the-job training, which is always necessary, is reduced. Nevertheless, it is arguable that the general skills being provided by Georgian institutions today are not in line with market needs. The development of certain skills, including "basic" critical and analytical ability, is not a central feature of the traditional education system. There is however a growing body of trade schools, some with donor funding, which are beginning to fill some of these gaps both directly and indirectly by forcing traditional institutions to rethink their curriculum. Because Georgia also benefits from a relatively young active population, including young retirees, adult education should be developed to facilitate re-entry into the workforce and reallocation of human resources to better uses, and to boost entrepreneurship.

Georgian entrepreneurship reportedly suffers from a lack of professional management, coupled with a great reluctance on the part of SME owners to "let go" – whether to give management the latitude it needs to perform, or to ask for help. Because SMEs are typically managed by their owners, and these do not have a clear business strategy nor day-to-day management skills, SME growth is constrained. There is no long-term development strategy and no financial forecasting. Recognition of marketing principles is growing, in that SMEs want to obtain and give information, albeit totally focused on local consumers and finances, there is no interest as yet for international markets or input sources.

Several donors have sought to address the training and consultancy needs of SMEs in Georgia, with different approaches. One of the bigger projects was the World Bank funded **CERMA**. CERMA sought to both provide business advice and develop the consultancy industry. In seven years, it has assisted approximately 150 companies, usually with under 15 employees. The project diagnoses the enterprise's problems, then designs and implements a plan to address these, with support from international consultants where local expertise is not available. The range of assistance spans $60,000 to $100,000, with a 5-10% cost share. The CERMA project has spun off a self-financing business school with a masters in executive management affiliated to European schools, and a consultancy which is not self-sustainable. Some critics argue that the design of the CERMA project is to blame for its limited success: by offering to pay for 95% of the consultancy costs, the World Bank encouraged consultants to push themselves onto companies who might not want or value the product; in turn, the recipient would either not apply the recommendations or not understand their true price, thinking them free, which would not encourage further hiring of consultants and could potentially undermine the development of the business consultancy industry. At any rate, the CERMA consultancy activity was discontinued upon request by then Minister of Economy Kakha Bendukidze, so that a going balance of $1.5 million be redirected to privatization (Kutaisi and Batumi airports, Gudauri hotel, telecom, Georgian Oil Company, Batumi shipbuilding, GeoPost).

Another, recently extended project is the EU's **Business Advisory Services** (BAS). In contrast to CERMA, BAS found it had no need to advertise its services, despite imposing a 50% cost share (down to 30% in the regions) and offering merely to match SME needs to local consultants. In two years, BAS has also undertaken 150 projects (of up to Euro 10,000 each) in companies with 10-150 staff. Each company can receive a maximum of two assistance projects, and each project is assessed a year on both to determine whether recommendations were implemented and to establish the company's satisfaction level. The USAID-funded **Georgia Employment and Infrastructure Initiative** (CHF) helps the remotest rural communities link up with urban markets, in coordination with MFI programs. It has identified serious non-financial information asymmetry and plans to fill the gap in identifying buyers and sellers (**USDA** did a little of this for a few products). CHF will offer brokering services in Samtskhe Javakheti, and business development services through existing business associations. A large share of its budget is expected to go to infrastructure development as determined by local stakeholders.

A **GEGI** grantee has identified three reasons for the suboptimal impact of business services in Georgia. First, there is initially low penetration, in that the people who need the help do not find out about possible help sources; when they hear by word of mouth, the programs are often over. Second is the poor quality of the training or materials, too frequently transposed from other countries and badly adapted or translated. And third, is inadequate coordination of donor programs, which repeat training and do not build on each other. Another **GEGI** grantee is developing accounting standards specifically for SMEs directly into Georgian and will provide training using professional Georgian trainers and its network of regional branches.

Current SME Environment

- The traditional education system is inadequate for the needs of a modern, market driven economy
- There is a multitude of successful businesses and donors providing useful training and educational materials, but the education system is either unaware of this or resisting the evidence
- Uneven SME awareness of training opportunities and benefits: some programs report having little need to advertise, others invest a lot of time in generating demand
- SMEs do not have the experience necessary to assess the quality of service providers before incurring the cost of training
- Many people qualified to provide SME support services on a commercial basis work for donors, earning substantially more
- The Ministry of Education has a monopoly over certification of professional training, but does not have any knowledge of modern, market-driven standards to use in measuring competency

Recommendations

- Education Reform: to establish what skills a modern, market-driven Georgia will need and design an education system that will meet these needs, thereby reducing the costs of retraining
- Sector-Specific Training: to provide skills upgrade for specific sectors (service quality, technical advice), where a good base is observed but incremental skills updating would radically improve productivity
- Donor Programs: to bring the necessary skill into the market until the education system can catch up, and do so at reduced costs and in a uniform way for SMEs
- Information Sharing: to collect the extensive materials prepared by donor-funded activities and provide access to a greater number
- Donor Coordination: to avoid duplication of effort and build synergies across programs
- Public Education: to wean the population away from expectations that the state will provide, and inform that other outlets are available to develop useful, marketable, modern skills
- Continuing Education: to keep educators at the forefront of business and SME needs, including by participating in donor training
- Donor Distortions: to minimize distortions created by donor programs, and avoid mismatching supply to actual demand or needs, also to reduce brain drain into the donor industry
- Certification: to reduce the costs to SMEs of establishing training quality
- Higher Business Education: to investigate local MBA programs in partnership with western institutions.

3. Business Representation: Advocacy and Public-Private Partnerships

A single SME has little power to affect the business environment on its own and most often has no influence on larger issues that determine the existence or overall level of costs and risks. Because of this, businesses in the West voluntarily form associations and organizations. One of their most important functions is to engage Government at various levels to ensure that the business environment meets the needs of the business community. In developed democracies, the public sector often consults the business sector; business and the public sector work together on local and national development strategies, tax regimes, administrative reforms, and any other point of interaction between Government and business. The business community requires effective organizations that can facilitate participation in the policy, lawmaking and strategy processes. This allows businesses to reduce costs of unnecessary government restrictions and interventions, and to anticipate changes. In contrast, many transition countries pass laws with no warning or notice, often causing the collapse or severe damage to SMEs who had invested based on existing rules and conditions.

Oxfam has recorded has a strong network of 37 business associations and 119 other organizations aimed at promoting business interests in Georgia. However, many smaller businesses choose not to integrate because they have little interaction with the state and prefer to address their own problems using informal methods rather than defending a common interest, which may attract undesired attention. A soon-to-be published IFC survey shows that SMEs that do join business associations do so for information and lobbying, though the latter they feel is of medium quality. **Oxfam** has created a small business owners' discussion club which has had some success in bringing common issues to the forefront. **GEGI** has been working with the more active Tbilisi based business associations that advocate for reform, and has found them to be capable of policy and legislative analysis and recommendation, though still relying on informal networks and personal connections for advocacy. Typically, established business associations (in Georgia and elsewhere) do not focus on SMEs which tend to be fiercely independent. As the SME sector grows however, entrepreneurs understand better their rights and interests and eventually put more effort into pressuring the authorities to respect these.

Current SME Environment
▪ Many associations were started by or for donor projects, so that they do not understand, represent or address member needs, nor are they sustainable without donors ▪ Some industry associations were created by sector professionals, to advocate for recognition of their profession and needs ▪ There is policy analysis and advocacy capacity in certain business associations and groupings ▪ The mechanisms for private-public dialogue are limited and opaque, leading many to either rely on personal contacts (which introduces personal advantage rather than greater good) or not participate at all ▪ Government is ill equipped to deal with business, it still sees its role as one of (oppressive) control and business as suspicious; business and especially Georgian SMEs are yet to be recognized as the engine of economic growth and a partner for public and social policy and development
Recommendations
▪ Dialogue Capacity: to develop both business associations' and Government's ability to share ideas and opinions and address problems as partners to set sustainable, workable policy parameters ▪ Government Client Service: to develop Government's willingness to listen and recognize that public exchange can resolve many issues, to introduce a central communication point by agency

- Government Coordination: to ensure that information provided by business to one agency is not overlooked, to increase effectiveness of business policy-making, in particular as regards SMEs which unite less
- Business Associations Support: to balance strengthening effective, useful business associations with reducing reliance on donor funds, to capture SMEs which are less inclined to coalesce into advocacy groups.

APPENDIX A - LAW ON THE SUPPORT TO SMALL AND MEDIUM ENTERPRISES

LAW ON THE SUPPORT TO SMALL AND MEDIUM ENTERPRISES

CHAPTER I

GENERAL PROVISIONS

Article 1

1. This Law defines economic and legal principles for the development of and support to small and medium enterprises in Georgia.
2. This Law, other laws and regulatory normative acts of Georgia constitute the legislation on small enterprises.

Article 2

1. Any organizational –legal entity established according to the provision of the Law of Georgia "On Entrepreneurs" with the average number of employees and annual turnover not exceeding the following fixed amount is considered as a small and medium enterprise:

a) small enterprises: 20 employees and GEL 500 000;

b) medium enterprise: 100 employees and GEL 1 500 000.

2. Organizations supporting small enterprises include unions and funds established and registered pursuant to the Civil Code of Georgia, the main purpose of which is to provide support to small enterprises.

Article 3

An enterprise shall not be deemed as small or medium if:

a) more than 25% of authorized capital belongs to a person or persons who do not comply with the requirements for enterprises stipulated by this Law;

b) the main activities thereof are bank, insurance and other types of financial services.

Article 4.

1. An average annual number of workers employed by an enterprise shall be determined by labor contract, including part-time employees (excluding seasonal workers), as well as

employees of representations of a legal person, which shall be specified in annual consolidated forms of economic and financial activity of such small or medium enterprise to be submitted to the regional authorities of the State Statistical Department.

2. An average number of workers employed by newly established enterprises with no previous financial year shall be determined according the number of workers employed within the period commencing from the date of registration thereof to the end of a year.
3. An enterprise shall not be deemed as small or medium upon the date on which the number of employees exceeds the marginal number established under Article 2 herein.
4. No additional obligation of accountability shall be imposed on small enterprises by item 1 of this Article, except as otherwise established by the Law.

Article 5

Annual turnover of small and medium enterprises is the total amount of receipts obtained by such enterprises within the previous financial year.

CHAPTER II
SMALL ENTERPRISE DEVELOPMENT AND SUPPORTING CENTER

Article 6

1. Small and Medium Enterprise Development and Supporting Center (hereinafter referred to as the “Center”) shall be established in order to work out and implement the state policy for development and support of small enterprises.
2. The Center represents a legal person of public law having its central and regional offices, the main purpose of which is to promote development of small and medium enterprises. The Center shall be managed and represented by its director.
3. According to the established procedure the Center shall be transferred the whole property of treasury enterprise, small business development promotion fund, and all the obligations undertaken in compliance with the purposes thereof.
4. The president of Georgia shall appoint and dismiss a director of the Center by recommendation of the Small and Medium Enterprises Coordination Council.
5. The Center shall have no right to issue any documents regulating small and medium entrepreneurial activity other than those concerning internal operations of such Center.

Article 7

1. The responsibilities of the Center are:

a) to coordinate state policy measures encouraging small and medium enterprise development;

b) to elaborate draft laws and international contracts concerning small and medium enterprise development and make conclusions thereon;

c) to organize elaboration and implementation of programs for development and financing of small and medium enterprises;

d) to organize training courses and workshops for personnel of small and medium enterprises;

e) to provide small and medium enterprises with information and consultation services;

f) to analyze and assess economic and financial activities of small and medium enterprises;

g) to assist foreign and local natural and legal persons in making investments in small enterprises;

h) to organize regular meetings with small and medium enterprises and their supporting organizations in order to create favorable environment for development of small and medium entrepreneurship in Georgia;

i) to carry out other arrangements encouraging development of small enterprises.

3. The Center shall exercise the responsibilities specified in item 1 of this Article in close cooperation with local, foreign, international, governmental and non-governmental organizations.

Article 8

1. The Center shall work out and maintain information system with database containing the following:

a) small and medium enterprises in Georgia;

b) small and medium enterprise supporting organizations;

c) data on organizations and persons rendering information and consultation services to small and medium enterprises;

d) information on projects, tenders, programs and training courses for small and medium enterprises;

e) data on investments in small and medium enterprises or investments made by such enterprises.

2. The information system stipulated in item 1 of this Article represents a part of communication and information infrastructure of the Center.

3. In the course of creating this system the Center shall cooperate with small and medium enterprise supporting organizations, as well as chambers of industry and sectoral unions;
4. The data shall be gathered from official sources and materials obtained as a result of study analysis of organizations interested in small and medium entrepreneurship.

Article 9

Thy Coordination Council shall determine organizational structure and directions of activity of the Center and regional bodies thereof.

CHAPTER III

SMALL ENTERPRISE COORDINATION COUNCIL

Article 10

1. The Small and Medium Enterprise Coordination Council (hereinafter "the Council) is a body carrying out small and medium entrepreneurship policy and directing the Center's activity.
2. Members of the Council shall be approved by the president of Georgia for the term of two years, which shall be composed of 13 persons, among them:

a) six shall be representatives of the Ministries of Economy, Industry and Trade; Finance; Agriculture and Food; Labor, Health and Social Care;

b) five representatives of each registered small and medium enterprise supporting organizations;

c) one representative of the National Bank;

d) one representative of the State Office.

3. No compensation shall be given to the members of the Council for participation in the activity of the Council
4. Candidates for the Council shall be nominated no later than 30 calendar days upon effective date of this Law.
5. Decision on appointment of members of the Council shall be made no later than 30 calendar days upon expiration of nomination period.
6. Members of the Council may resign by their own will or by decision of the organization, which nominated such members.

7. Appointment of a new member replacing his/her predecessor shall be carried out in compliance with the procedure prescribed by item 1 of this Article. Candidates shall be nominated no later than 30 days upon the resignation or dismissal of a member of the Council.
8. A chairman of the Council shall be elected from the members of the Council by majority of votes of such members.
9. Meetings of the Council shall be held once a quarter. A meeting is duly constituted if there are present at least 2/3 of members of the Council.
10. The Council shall make decisions by majority of votes. In case the votes are equally divided, the casting vote shall be that of the chairman.

CHAPTER IV

STIMULATION MEASURES FOR SMALL AND MEDIUM ENTERPRISE FORMATION AND DEVELOPMENT

Article 11

Small and medium enterprise formation and development shall be promoted by:

a) financial support;
b) working out and implementation of programs providing small enterprises with financial support;
c) rendering information and consultation services to small and medium enterprises;
d) implementation of occupational training projects for the employees of such enterprises;
e) providing leasing service to small and medium enterprises;
f) formation of small and medium enterprise supporting infrastructure;
g) complying with the requirements of the present or other laws of Georgia.

Article 12

1. The Council shall present to the President for approval small and medium enterprise state support programme;
2. Small and Medium enterprise State Support is provided on a base of relevant state, filed and regional programs. Programs should include:

a. perspective ways of small and medium entrepreneurship support infrastructure;

b. assist poor participate in entrepreneurship;
c. activities of creation small and medium entrepreneurship support infrastructure;
d. staff training and re-training activities;
e. proposals for creating preferential conditions for using state financial, information and technical resources, as well as material and technical processing and technology;
f. proposals creating a system for attracting and using investment (among them foreign investment);
g. proposals for supporting foreign economic activities of small and medium enterprises;
h. special financial support programs;
i. proposals for defining priorities for small and medium enterprises for the state procurement of goods and services;
j. other issues defined by small and medium enterprise state support policy.

3. Small and medium enterprise support state programs should be worked out according to the law and should correspond to the population employment state programs, implementing migration policy, solving ecology and other problems.
4. Small and medium enterprise assistance organizations can work out and implement small and medium enterprise support programs independently, create support funds, also present projects and proposals to federal and local authorities for including them in state regional programs.

Article 13

The Center shall not allocate funds to any enterprise or organization owned by a member of the Council or a person being in mutual relation therewith as defined by the applicable legislation of Georgia. In the event that the funds are allocated in violation of this item such funds shall be immediately repaid to the Center.

Article 14

Financial activity of the Center shall be audited at least once a year. The audit report shall be submitted to the president of Georgia and be made available for any person.

Article 15

1. The State Statistical Department shall be entitled to carry out annual statistical research of small enterprises' activities pursuant to the requirements prescribed by Article 2 of this Law and submit summarized information to the Center.

2. The Director of the Center shall, on an annual basis, submit outcomes of the research and observation as provided by item 1 of this Article, as well as additional information, to the president of Georgia.

Article 16

1. Small enterprises shall be provided with the financial support for the purpose of:

a) elaboration and implementation of small enterprise formation and development programs;

b) organizing training courses and workshops for the employees of small enterprises;

c) providing information services to small enterprises, including publication of guidelines and booklets.

2. Financial support to small and medium enterprise formation and development shall be carried out in the way of direct investment and/or through commercial banks selected according to the tender procedure.

3. The Consultation Council shall establish amount, form and proportions of financial support for carrying out measures prescribed by items 1 and 2 of this Article.

Article 17

Financial resources of the Centre may be:

a. Funds allocated from the central and local budgets;
b. state property privatization proceeds;
c. revenues received from the fulfilled state order;
d. revenues from the fulfilled agreements;
e. loans and grants from local and foreign donors and international financial organizations;
f. other revenue not prohibited by the legislation of Georgia.

Article 18

When implementing the programs the ministries and other governmental institutions of Georgia shall, within the scope of their competence, take the following into the account:

a) increase in number of workers employed by small and medium enterprises;

b) extension of export activities of small and medium enterprises and improving the competitive capacity thereof;

c) encouragement of investments in small and medium enterprises.

d) improving information and consultation services rendered to small and medium enterprises;

e) improving professional and entrepreneurial skills of workers employed by these enterprises.

Article 19

Control over small and medium enterprise activity shall be carried out according to the procedure established by the legislation of Georgia.

Article 20

Small and medium enterprises may, for the purpose of solving the common problems in connection with the public support and development of small and medium enterprises, establish unions and funds.

Article 21

Small and medium enterprises enjoy privileges envisaged by the Tax Code of Georgia.

Article 22

Small and medium enterprises participating in state procurement operations enjoy the privileges stipulated by the law.

Article 23

For small and medium enterprises simplified accounting and reporting system shall apply.

CHAPTER V

FINAL PROVISIONS

Article 24

The present Law of Georgia shall enter into force upon its publication.

President of Georgia: Eduard Shevardnadze

July 23, 1999

No. 2341-RS

APPENDIX B - ROUNDTABLE PARTICIPANTS

	Organizations	Participants
1	American Chamber of Commerce	Amy Denman, Sarah Williamson
2	Association of Georgian Exporters	Tamaz Agladze
3	Association of Georgian Young Financiers and Businessmen	Tariel Giorgadze
4	Caucasus Brand Protection Group	Esbern Emborg
5	Employers' Association of Georgia	Konstantine Jgenti
6	Georgian Business Confederation	Saba Sarishvili
7	Georgian Federation of Professional Accountants and Auditors	Lavrenti Chumburidze
8	Georgian Young Lawyers' Association	Tamuna Metreveli
9	Georgian Chamber of Commerce	Gia Kakabadze
10	Association of Small Enterprises	Tamaz Vashakidze, Anzor Sakandelidze
11	Association of Oil Product Importers and Distributors' Rights	George Kotrikadze
12	Association of Farmers' Rights Defense	Kakha Nadiradze
13	The Georgian Association of Women in Business	Nino Elizbarashvili
14	Association "Banking-Finance Academy of Georgia"	Nino Jgamadze
15	Georgian Marketing Association	Buba Lezhava
16	Movement for Sustainable Development of Georgia	Shalva Givishvili
17	Georgia Development Gateway Union	Teimuraz Kancheli
18	Association of Young Scientists of Agriculture and Food Industry	Kakha Mukhiguli
19	Business Development Supporting Association	Elza Baliashvili
20	Poultry Association	Irakli Chikhladze
21	Association for Investment Support in Georgia	Merab Labadze
22	Georgian International Road Carriers Association	Zurab Kviriashvili
23	ABCO-Georgia	Konstantine Jgenti
24	Taxpayers' Union	Vladimir Kharatishvili
25	Small and Medium Trade & Industry Entrepreneur's Union	Nino Mamukelashvili
26	Caucasus Business School	David Tsiklauri
27	European School of Management	Marina Karchava
28	Partnership for Social Initiatives	Nick Loladze
29	IFC	Frank Lever
30	Chemonics	Jeff Ferry
31	AgVANTAGE	Giorgi Rusitashvili
32	Development Alternatives, Inc.	Giorgi Dangadze
33	The Eurasia Foundation	Ani Jobava
34	Audit Consulting International Corporation	Giorgi Leiahsvil
35	State Minister	Jambul Bakuradze
36	State Chancellery	Vasil Managadze, Shalva Kurdiani

APPENDIX C - PERSONS AND ORGANIZATIONS INTERVIEWED

	Organization	Contact
1	Georgian Federation of Professional Accountants and Auditors	Lavrenti Chumburidze
2	Georgian Chamber of Commerce	
3	Association of Small Enterprises	Tamaz Vashakidze
4	Georgian Association of Women in Business	Nino Elizbarashvili
5	SMEDA/ABCO	Konstantin Jgenti
6	Association of Georgian Banks	Zurab Gvasalia
7	Leasing Association	Giorgi Putkaradze
8	AmCham	Amy Denman
9	Employers Associations of Georgia	Elguja Meladze
10	Association for the Protection of Landowners Rights	Jaba Ebanoidze
11	Association of Georgian Young Financiers and Businessmen	Tariel Giorgadze
12	Caucasus School of Business	
13	Credit Union Development Center	Natia Jorjikia
14	Banking – Finance Academy	Nino Jgamadze
15	ProCredit Bank	Lida Vardania
16	Constanta	Levan Mosakhlishvili
17	CREDO (World Vision MFI)	Gerlof de Korte
18	Bank of Georgia	Shota Machavariani
19	Economic Policy and Research Center	David Tchkadua
20	Young Economists Association	
21	Young Bankers Association	Irakli Kilauridze
22	CERMA	Sandro Khizanishvili
23	Eurasia	Ani Jobava
24	Open Society	n/a
25	Oxfam	Anna Akhvlediani
26	Integrated Employment Development and SME Development Program (UNDP)	Revaz Sakvarelidze
27	Business Incubator Initiative Georgia	Vazha Goginashvili
28	National Investment and Export Promotion Agency (MOED)	David Natroshvili
29	Ministry of Finance	
30	Budget & Finance Committee of Parliament	Roman Gotsiridze
31	EBRD/Small Enterprise Lending Programme	Michael Kortenbusch
32	World Bank	Tata Kandelaki
33	GTZ & KfW	Klaus Buschhoff
34	EU-Business Advisory Services	Gela Kodalashvili
35	International Monetary Fund	Robert Christiansen
36	International Finance Corporation	Frank Lever
37	AgVANTAGE	Roger Bird
38	Georgia Microfinance Stabilization and Enhancement	Jeff Ferry, Giorgi Otaridze
39	Georgia Employment and Infrastructure Initiative	Patrick Sommerville
40	Restructuring Assistance and Policy Advice for the Ministry of Agriculture and Food of Georgia	Don Van Atta

APPENDIX D - BIBLIOGRAPHY

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APPENDIX E – EUROPEAN CHARTER FOR SMALL ENTERPRISES

APPENDIX F - SUPPORTING DOCUMENTS